Financial Services Update

March 4, 2015

HIGHLIGHTS

Federal Regulatory Developments

HUD Says CFPB's Annual Adjustments to the Points and Fees Test Applies to HUD's QM Definition

State Regulatory Developments

Montana Revises and Clarifies its Mortgage Act

Litigation Developments

Judge Rejects Equitable Tolling Claim in RESPA Case

Eleventh Circuit Rules Unnamed Class Members Beyond District Court's Jurisdiction

WBK News

Jason McElroy will speak on recent regulatory and enforcement trends from the CFPB to QBE's Operations Managers' Roundtable on March 4 in Nashville, TN. For more information contact Jason at mcelroy@thewbkfirm.com.

Jack Konyk will present an overview of a variety of regulatory topics at the Northeast Regional Conference of MBA's on March 12 in Atlantic City, NJ. For more information contact Jack at konyk@thewbkfirm.com.

Michael Kieval, **Jason McElroy**, and **Jeffrey Blackwood** published an article titled "Lenity and Deference on a Collision Course" in Banking Law 360 on February 26, 2015.

SUMMARIES

Federal Regulatory Developments

HUD Says CFPB's Annual Adjustments to the Points and Fees Test Applies to HUD's QM Definition

HUD issued a rule on February 17, 2015 clarifying that all annual adjustments to the points and fees limit issued by the CFPB to reflect the Consumer Price Index apply to HUD's Qualified Mortgage (QM) definition for FHA loans.

HUD's QM definition incorporates by cross-reference the CFPB's points and fees limit provided in Regulation Z § 1026.43(e)(3), which includes the requirement that the CFPB adjust the points and fees limit annually for inflation. The CFPB issued a rule on August 15, 2014 that did just that to reflect a 2-percent increase in the CPI-U, effective January 1, 2015.

The new HUD rule clarifies that all annual adjustments to the QM points and fees limit issued by the CFPB, including the CFPB's adjustments issued August 15, 2014, apply to HUD's points and fees limit provision per the effective date of the CFPB's adjustments.

The following are the CFPB's adjusted points and fees thresholds that became effective January 1, 2015:

- If the loan amount is greater than or equal to $101,953, the transaction's total points and fees must not exceed 3 percent of the total loan amount;
- If the loan amount is greater than or equal to $61,172 but less than $101,953, the transaction's total points and fees must not exceed $3,059;
- If the loan amount is greater than or equal to $20,391 but less than $61,172, the transaction's total points and fees must not exceed 5 percent of the total loan amount;
- If the loan amount is greater than or equal to $12,744 but less than $20,391, the transaction's total points and fees must not exceed $1,020; and
- If the loan amount is less than $12,744, the transaction's total points and fees must not exceed 8 percent of the total loan amount.

HUD's rule is available at: http://www.gpo.gov/fdsys/pkg/FR-2015-02-17/pdf/2015-03139.pdf. The CFPB's August 15, 2014 rule that issued the annual adjustments is available at: http://www.gpo.gov/fdsys/pkg/FR-2014-08-15/pdf/2014-18838.pdf.

State Regulatory Developments

Montana Revises and Clarifies its Mortgage Act

The state of Montana on February 18, 2015 enacted a statute revising and clarifying certain licensing and servicing definitions and requirements of the Montana Mortgage Act, Mont. Code Ann. § 32-9-101 *et seq.* (the "Act").

Montana's modifications to the Act will become effective on **October 1, 2015**.

Definitions of Brokers, Lenders, Loan Originators and Servicers

Montana's revisions expanded the definitions of "mortgage broker," "mortgage lender," "mortgage loan originator" and "mortgage servicer" (collectively, the "mortgage entities"). In each instance, the applicable definition now applies to a person or entity that presents itself to the public as engaging or being able to engage in the conduct or services applicable to the definition.

For example, the Act currently defines a mortgage lender as an entity that closes a residential mortgage loan, advances funds, offers to advance funds, or commits to advancing funds for a mortgage loan applicant. The revisions will expand this definition to include an entity that indicates it is able to perform any of these functions.

Revisions to Licensing of Mortgage Entities

Under the Act, a person generally must be licensed in order to regularly engage in the business of a mortgage entity. "Regularly engaged" is currently defined as engaging in business as one of the types of mortgage entities on more than 12 mortgage loans in a calendar year. This has now been amended to more than five loans in a calendar year to reach the definition of "regularly engaged."

The revisions further clarify that each main office and branch office of a licensee or registrant must be within the United States or a territory, including Puerto Rico and the U.S. Virgin Islands.

In addition, the Act currently prohibits any person from regularly engaging in the business of a mortgage entity unless that person is licensed under the provisions of the Act or registered through the Nationwide Mortgage Licensing System & Registry (NMLS). These revisions tie the Act's licensing provisions directly to NMLS registration, so that a person will become licensed or registered under the Act as a mortgage entity through the NMLS. Montana will now use the NMLS forms and policies for all licensing actions.

Control Persons

The Act requires certain persons to independently meet the requirements established in Mont. Code Ann. §§ 32-9-120(1)(a) through (1)(c) and (1)(g) in order for an entity they are associated with to be considered for a state license or license renewal. Currently, such people consist of (1) ultimate equity owners of 25 percent or more of the applicant if the equity owners are individuals, (2) control persons of the applicant if the control persons are individuals, and (3) individuals who control, directly or indirectly, the election of 25 percent or more of the members of the board of directors of the entity.

As revised, the persons described above are replaced with persons with "control" of the entity, as that term is currently defined under the Act.

Independent Contractors

Montana has revised the Act to clarify certain independent contractor provisions. First, the revisions define "independent contractor entity" to mean an entity that offers or provides clerical or support duties for another person.

The term "clerical or support duties" is further defined to include the receipt, collection, distribution and analysis of information common for the processing or underwriting of a residential mortgage loan. It also includes communicating with a consumer to obtain the information necessary for the processing or underwriting of a residential mortgage loan, to the extent that the communication does not include offering or negotiating loan rates or terms, or counseling consumers about residential mortgage loan rates or terms.

Expressly excluded from "clerical or support duties" are taking a residential mortgage loan application, or offering or negotiating the terms of a residential mortgage loan.

The Act also currently requires that an independent contractor entity designate a responsible individual for each main office and each branch office. The revisions define "responsible individual" to mean a Montana-licensed mortgage loan originator with at least one and a half years of experience as a mortgage loan originator, or a registered mortgage loan originator who is designated by the independent contractor entity as the individual responsible for the operation of a particular location under the responsible individual's full management, supervision and control.

In addition, the revisions to the Act remove the entire provision which currently states that an independent contractor may not engage in "residential loan origination activities" (as currently defined in the Act) as a loan process or underwriter with respect to any dwelling or residential real estate in Montana unless the individual first registers as a mortgage loan originator through the NMLS and obtains a valid mortgage loan originator license. The revisions also remove the definition of "residential loan origination activities."

Loan Processors and Underwriters

The Act currently defines a “loan processor or underwriter” in part as an individual who performs administrative or clerical tasks as an employee at the direction of and subject to the supervision of a licensed or registered mortgage loan originator. The revised definition will eliminate the phrase “administrative or clerical tasks” and replace it with the defined term of “clerical or support duties,” as described above.

Exempt Entity Registration

The revisions removed from the Act the ability of a person who is exempt from, or not required to be licensed or registered under the Act, to register on the NMLS as an exempt registrant for purposes of sponsoring a mortgage loan originator and for purposes of satisfying the mortgage loan originator bonding requirements.

Conduct of Employees and Designated Managers

Currently under the Act mortgage brokers and mortgage lenders are responsible for the conduct of their employees, including conduct that violates federal laws and regulations applicable to the origination of residential mortgage loans, and violations of the Act or rules adopted pursuant to the Act. Designated managers currently are responsible for their own similar conduct and that of each employee at the location managed by the designated manager.

The revisions now expand the responsibility for conduct to include violations of all federal or state laws, rules, or regulations.

Notice and Surety Bonds

The revisions clarified that notice required to be given to the Department of Administration by mortgage entities or obligors must now go through the NMLS. Surety bonds also now may be filed with the NMLS.

Litigation Developments

Judge Rejects Equitable Tolling Claim in RESPA Case

In a recent case challenging captive reinsurance arrangements between private mortgage insurers and lender-affiliated reinsurers, the Chief Judge of the U.S. District Court for the Middle District of Pennsylvania held that plaintiffs who waited “more than half a decade” to pursue their RESPA Section 8 claim failed to exercise the due diligence necessary to support the extraordinary relief of equitable tolling.

In so holding, the district court sided with a recent Third Circuit panel decision rejecting the application of equitable tolling in another of the many cases that took issue with such captive reinsurance arrangements.

In *Cunningham v. M&T Bank Corp.*, each of the named plaintiffs was required to purchase private mortgage insurance (PMI) for their respective mortgage loans. The plaintiffs alleged that their lender referred them to private mortgage insurers who, in turn, ceded a portion of the plaintiffs' monthly PMI premiums to an affiliate of the lender for the purchase of reinsurance.

The plaintiffs claimed that this arrangement constituted the payment of kickbacks and/or unearned fee splits in violation of Section 8 of the Real Estate Settlement Procedures Act (RESPA) because the lender-affiliated reinsurer assumed little to no risk of loss in exchange for the premiums it received.

There was no dispute that the plaintiffs' RESPA claim was limited by time. Yet the plaintiffs claimed they were entitled to equitable tolling, which requires a showing of active misleading by the defendant that prevented the plaintiffs from discovering their claim within the limitations period despite their exercise of due diligence.

After a period of discovery on the equitable tolling issue, the defendants moved for summary judgment.

In determining whether equitable tolling should apply, the court noted that each plaintiff received disclosures at their respective loan closing, which advised them of the possibility that their PMI would be reinsured by an affiliate of the lender. The plaintiffs also were provided the opportunity to opt out of such an arrangement. None of the plaintiffs opted out or even inquired about the reinsurance arrangements until they received a solicitation letter from counsel many years after their loan closings.

The plaintiffs argued that the disclosures misrepresented the legitimacy of the arrangements and thus prevented them from discovering their claims on time. The court, however, focused on the plaintiffs' complete failure to exercise any due diligence within the limitations period, finding that plaintiffs "relied solely and docilely upon [the lender's] assertion that its arrangement was legitimate until solicited by counsel more than half a decade after the limitations period expired."

The court noted, "Equitable tolling is an 'extraordinary remedy,' sparingly granted and wholly inapplicable in the absence of a showing that plaintiffs exercised *some* degree of diligence during the limitations period."

The court's conclusion in *Cunningham* is consistent with the Third Circuit's decision last fall in *Riddle v. Bank of America Corporation*, another PMI reinsurance case that is factually indistinguishable on the due diligence issue. In *Riddle*, the Third Circuit also emphasized the plaintiffs' failure to conduct any investigation. The court pointed out, "Taking the defendants' representations at face value without asking a single question

for seven years is insufficient diligence to toll the statute of limitations in these circumstances."

While the Third Circuit designated the *Riddle* opinion as "not precedential," meaning it is limited to the facts of that case, it nonetheless represents the application of well-established equitable tolling principles that, as demonstrated by the *Cunningham* case, may be persuasive in factually similar cases.

The plaintiffs in *Cunningham* have appealed to the Third Circuit, and presently there are no less than 10 PMI reinsurance lawsuits pending in federal district courts in Pennsylvania and elsewhere.

The attorneys at Weiner Brodsky Kider PC regularly handle cases alleging violations of RESPA and other federal consumer lending laws, throughout the United States.

Eleventh Circuit Rules Unnamed Class Members Beyond District Court's Jurisdiction

The U.S. Court of Appeals for the Eleventh Circuit recently ruled that the jurisdictional limitations of Article III of the U.S. Constitution preclude district courts from issuing provisional holdings regarding the putative claims of unnamed plaintiffs prior to class certification.

Specifically, the Court of Appeals reversed a district court's ruling that a defendant would be prevented from moving to compel arbitration of unnamed plaintiffs' claims. In so holding, the Eleventh Circuit noted that class certification is the "critical act" which renders unnamed class members subject to the district court's power.

In *Larsen v. Citibank FSB* (*In re Checking Account Overdraft Litigation*), plaintiffs in five separate putative class actions claimed that several banks had unlawfully charged overdraft fees to their checking accounts. Notably, plaintiffs' checking accounts were governed by agreements providing for the arbitration of all disputes.

Despite the arbitration agreements, one defendant elected not to seek arbitration, and instead moved to dismiss. The defendant, however, later moved to compel arbitration of the named plaintiffs' claims in light of *AT&T Mobility LLC v. Concepcion*, in which the Supreme Court held that Section 2 of the Federal Arbitration Act preempts state laws voiding consumer arbitration agreements.

The district court denied the motion, ruling that the defendant had waived its right to compel arbitration of the named plaintiffs by failing to timely move to enforce the arbitration agreements.

The named plaintiffs moved for class certification shortly thereafter. Opposing this, the defendant argued, *inter alia*, that the putative class lacked sufficient numerical scale,

contending that those *unnamed* class members with enforceable arbitration agreements should be excluded from the class.

Concurrently, the defendant moved to dismiss the claims of the unnamed class members in favor of arbitration, pending the district court's ruling on the motion for class certification. The district court denied the defendant's conditional motion to dismiss, explaining that the court's "jurisdiction [over the putative class] was fixed on the day the original complaints were filed," and that, upon certification, such "absent class members" would be subject to the court's earlier ruling that the defendant had waived its right to compel arbitration.

In reversing the district court's ruling, the Eleventh Circuit held that, because a class had not yet been certified at the time of the district court's ruling, those unnamed class members remained mere *putative* participants to the litigation and, thus, were beyond the district court's jurisdiction.

The Court of Appeals further noted that the district court's "pronouncement" amounted to an order to "definitively foreclose the arbitration of the hypothetical claims that might be raised in the future by hypothetical plaintiffs [and could not] be regarded as anything but an impermissible advisory opinion."

The attorneys at Weiner Brodsky Kider PC regularly handle challenges to putative class actions throughout the United States.