

Government Enforcement and Litigation Trends

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GOVERNMENT ENFORCEMENT AND LITIGATION TRENDS

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What to expect from the Trump administration?

Redlining: *United States v. KleinBank*, No. 17-136
(D. Minn.)

Disparate impact

- Treasury report recommends "reconsidering" HUD disparate impact rule
- Executive Order 13777 requiring evaluation of regulations that are "outdated, unnecessary, or ineffective"
- District court insurance industry challenges

PHH Corporation v. CFPB, No. 15-1177 (D.C. Cir.)

Who is in charge at the CFPB?

Increased state enforcement and private lawsuits?

CFPB Order: American Express Bank (2017)

Overview of allegations

- ECOA violations arising from “provid[ing] products and services to consumers in Puerto Rico, the U.S. Virgin Islands ['PRVI'] and the Pacific Territories ... that were inferior in many respects to Respondents' card products' terms, conditions, servicing, and collections practices in the United States”

Root Cause: International division managed PRVI cards, while U.S. division managed cards in U.S. market

- “application of specific different policies ... resulted in discrimination” and “policies are not justified by a legitimate business need”

Consider: Implications for business organization

CFPB Order: American Express Bank (2017)

Self-mitigating conduct

- Amex “self-identified and reported the [offending] policies and practices to the Bureau, discontinued them, and proactively worked with the Bureau in its remediation of disparities,” including “self-identified disparities in pricing and other terms and conditions, underwriting, customer and account management services, and collections practices between their PRVI cards and their U.S. cards, as well as disparities with respect to consumers who indicate a Spanish-language preference”
- Amex “voluntarily provided approximately \$95 million of remediation to approximately 222,000 consumers”

Consider: Impact of self-reporting = no civil penalties

Perez v. Wells Fargo & Co. (N.D. Cal. 2017)

Overview of allegations

- Plaintiffs are non-permanent resident aliens who applied for unsecured credit without cosigners (e.g., credit cards, student loans)
- Underwriting guidelines required applicant for credit to be either a citizen of the U.S. or a permanent resident with a cosigner who is a U.S. citizen
- Plaintiffs' credit applications denied because plaintiffs did not meet citizenship requirements
- Suit alleging discrimination on the basis of alienage filed under 42 U.S.C. § 1981: “[a]ll persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts ... as is enjoyed by white citizens”

Perez v. Wells Fargo & Co. (N.D. Cal. 2017)

Overview of defense

- Motion to dismiss argued that the Section 1981 discrimination claim fails in light of the ECOA → “alienage is not within the purview of the ECOA”
 - 12 C.F.R. § 202.6(b)(7): “creditor may consider applicant's immigration status or status as a permanent resident of the United States, and any additional information that may be necessary to ascertain the creditor’s rights and remedies regarding repayment”
- Court rejected argument seeking “to avoid the proscriptions of Section 1981 by relying on the absence of protections for aliens under the ECOA”
 - “A creditor can comply with Section 1981 and the ECOA by not discriminating on the basis of any of the categories listed in the two statutes”

Consider: Dangers of motions to dismiss

Perez v. Wells Fargo & Co. (N.D. Cal. 2017)

Consider: How to interpret judicial orders?

Consider: Do eligibility policies for secured or unsecured credit distinguish between permanent and nonpermanent resident alien applicants? What is the justification?

- *Freddie Mac Single-Family Guide* Chapter 5103.2: “A non-U.S. citizen who is lawfully residing in the U.S. as a permanent or nonpermanent resident alien is eligible for Mortgage on the same terms as a U.S. citizen. A Mortgage to a non-U.S. citizen who has no lawful residency status in the United States is not eligible for sale to Freddie Mac.”

Consider: How will regulators view the issue?

Consider: What is your risk appetite for the issue?



Thank You

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RECENT DEVELOPMENTS IN FAIR LENDING LITIGATION

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Overview

Challenges to HUD Disparate Impact Rule

City of Los Angeles – Ninth Circuit's Decision
Affirming Summary Judgment for Banks

City of Miami – Supreme Court's Decision
Establishing Proximate Cause Pleading Standard

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Challenges to HUD Disparate Impact Rule

CHALLENGES TO HUD DISPARATE IMPACT RULE

2013 HUD disparate impact rule set burdens and standards of proof for Fair Housing Act (FHA) disparate impact claims

In *PCIAA v. HUD*, 13-cv-08564 (N.D. Ill.), and *AIA/NAMIC v. HUD*, 13-cv-00966 (D.D.C.), insurance industry challenged the HUD rule as inconsistent with:

- *Texas DHCA v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (2015), and
- *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642 (1989)

CHALLENGES TO HUD DISPARATE IMPACT RULE

Both insurance industry challenges to the HUD disparate impact rule assert that:

- Rule fails to require isolation of specific policy, proof of statistically-significant adverse impact on subject group, or proof of robust causal link between alleged policy and harm
- Rule requires defendant to prove that practice is “necessary” to achieve “substantial, legitimate, nondiscriminatory interests”
- Rule does not require plaintiff to prove that a less discriminatory alternative is “equally effective” in serving defendant’s interests

CHALLENGES TO HUD DISPARATE IMPACT RULE

In *AIA*, parties completed summary judgment briefing in 2016; new administration has not taken position on briefing

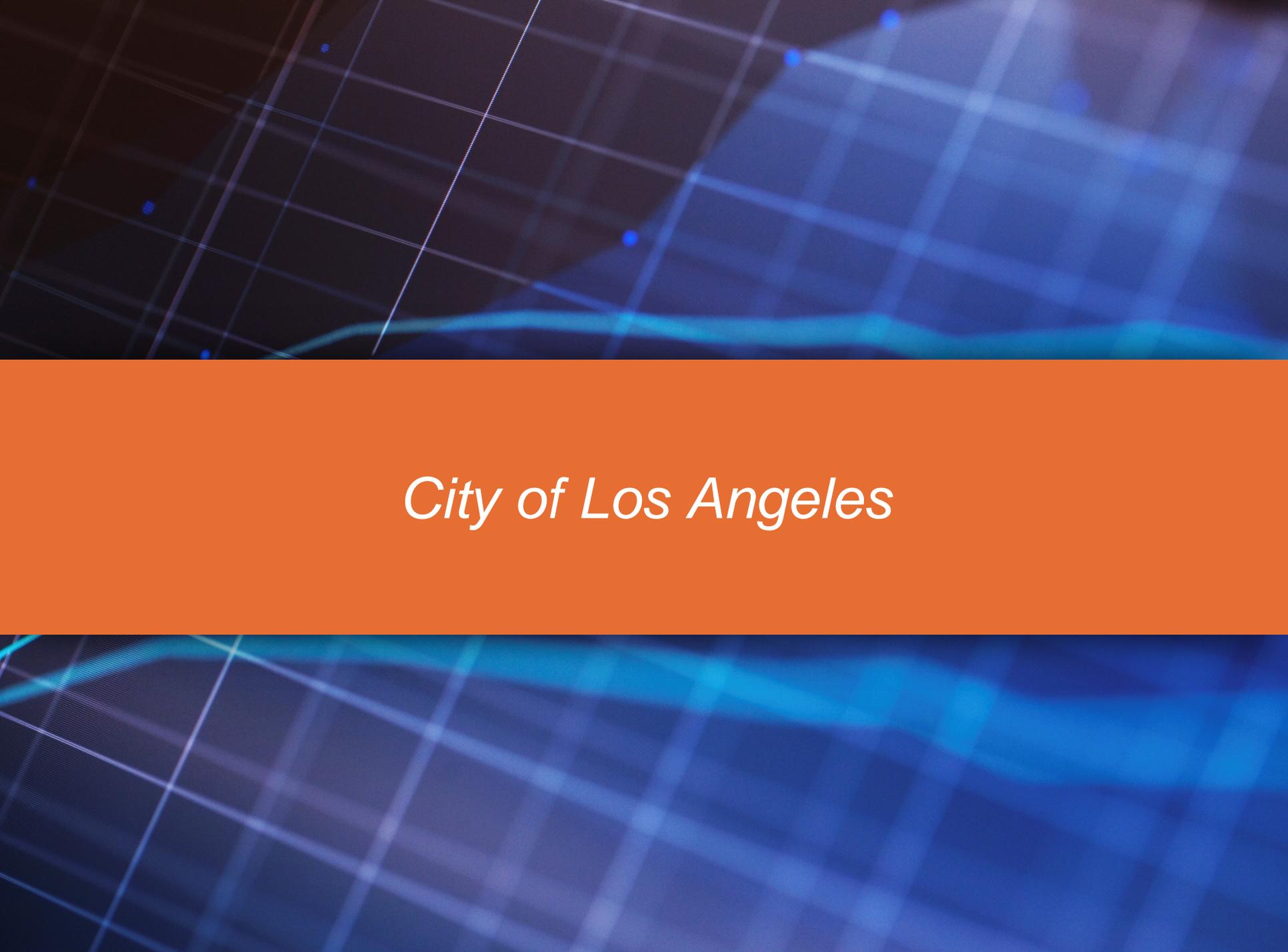
In *PCIAA*, by contrast

- N.D. Illinois had ordered HUD to reexamine rule in 2014
- In 2016, HUD determined no changes necessary, because rule allowed for a “case-by-case assessment” of challenged policies; new administration did not contradict position in 2017 briefing
- Court then found *PCIAA*'s arguments should be analyzed in “specific cases” rather than in a “facial, pre-enforcement challenge” – 2017 WL 2653069 (June 20, 2017), but conceded relevance of *Inclusive Communities* in performing that analysis

CHALLENGES TO HUD DISPARATE IMPACT RULE

Considerations

- Monitor government enforcement matters and private lawsuits for challenges to particular lending or servicing policies – e.g., challenge to use of “lender credits” in municipal fair lending lawsuits
- Regularly review business policies and guidelines
- Document reasons for business policies and guidelines

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City of Los Angeles

City of Los Angeles

Municipal fair lending cases seek to challenge lending practices of major banks dating back to 2004

In *City of Los Angeles*, banks prevailed at summary judgment – C.D. California found no evidence of FHA violations during 2-year limitations period

9th Circuit affirmed, adopting *Inclusive Communities* test for assessing FHA disparate impact claims, 691 Fed. App'x 453 (2017)

City of Los Angeles

Under *City of Los Angeles*, plaintiff must have evidence of a statistical disparity, of the specific policy that caused the disparity, and of a "robust" causal link between the policy and alleged disparity

9th Circuit ruled Los Angeles failed to establish a causal link between alleged racial disparities and either loan officer compensation policies or marketing efforts to low-income borrowers

- Rather, the Court found these policies would affect borrowers equally, regardless of race

9th Circuit ruled that the alleged "failure to monitor" loans for disparities was not a policy at all

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City of Miami

City of Miami

Bank of America Corp. v. City of Miami, 137 S. Ct. 1296 (2017)

Court reviewed whether Miami's claims satisfied the zone of interests and proximate cause requirements of the FHA

Regarding zone of interests, the majority found the Court was bound by *stare decisis*

- A plaintiff is within FHA zone of interests and establishes discrimination injury to itself – e.g., in *Gladstone Realtors v. Village of Bellwood*, 441 U.S. 91 (1979), village claimed discrimination injury (i.e., loss of integrated neighborhoods) from a realtor's racial steering

City of Miami

Regarding proximate cause, all eight participating justices agreed on a standard that a plaintiff must meet in pleading a FHA claim

- Foreseeability alone cannot establish proximate cause under FHA; "proximate cause ... bars suits for alleged harm that is 'too remote' from the defendant's [alleged] unlawful conduct"
 - "[E]ntertaining suits to recover damages for any foreseeable result of an FHA violation would risk massive and complex damages litigation"
- Thus, the FHA requires "some direct relation between the injury asserted and the injurious conduct alleged"
- "[H]ousing market is interconnected with economic and social life. A[n] alleged violation of the FHA may, therefore, be expected to cause ripples"
- But "[n]othing in the statute suggests that Congress intended to provide a remedy wherever those ripples travel"

City of Miami

Because the 11th Circuit applied the wrong proximate cause test, the Supreme Court vacated, directing:

- Lower court to “define, in the first instance, the contours of proximate cause under the FHA and decide how that standard applies to [Miami's] claims for lost property-tax revenue and increased municipal expenses”

Justices Thomas, Kennedy, and Alito concurred with the proximate cause ruling, observing:

- “Miami's own account of causation shows that the link between the alleged FHA violation and its asserted injuries is exceedingly attenuated”
- “Court of Appeals will not need to look far to discern other, independent events that might well have caused the injuries Miami alleges”



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Analytics Update

Post Inclusive Communities

- Increased focus on correlation vs causation
 - Plaintiff's / Government's burden is clarified
 - Defendants have more avenues to pursue
- These are difficult analytical questions

Who is in charge of analytics at the CFPB

- Enforcement or Supervision?
- Supervision increasingly "urgent" approach to outstanding PARR letters
- Less dogmatic approach in ***selected*** areas

Inter-Agency differences remain pronounced on analytical issues

A focus on treatment of consumers

Redlining

- Mortgage: large and small, retail, and wholesale
- Non-Mortgage: credit cards, indirect auto

Credit Reporting

- Harm to credit scores from incorrect data
- Mishandling of accurate data
- Hacking and breaches

Underwriting and risk-based pricing

Servicing practices in all forms of consumer lending

- Debt collect, forbearance, modifications, foreclosures, and repossessions

Implications

Enforcement actions and litigations more focused on 'bad-actors' rather than 'industry' issues

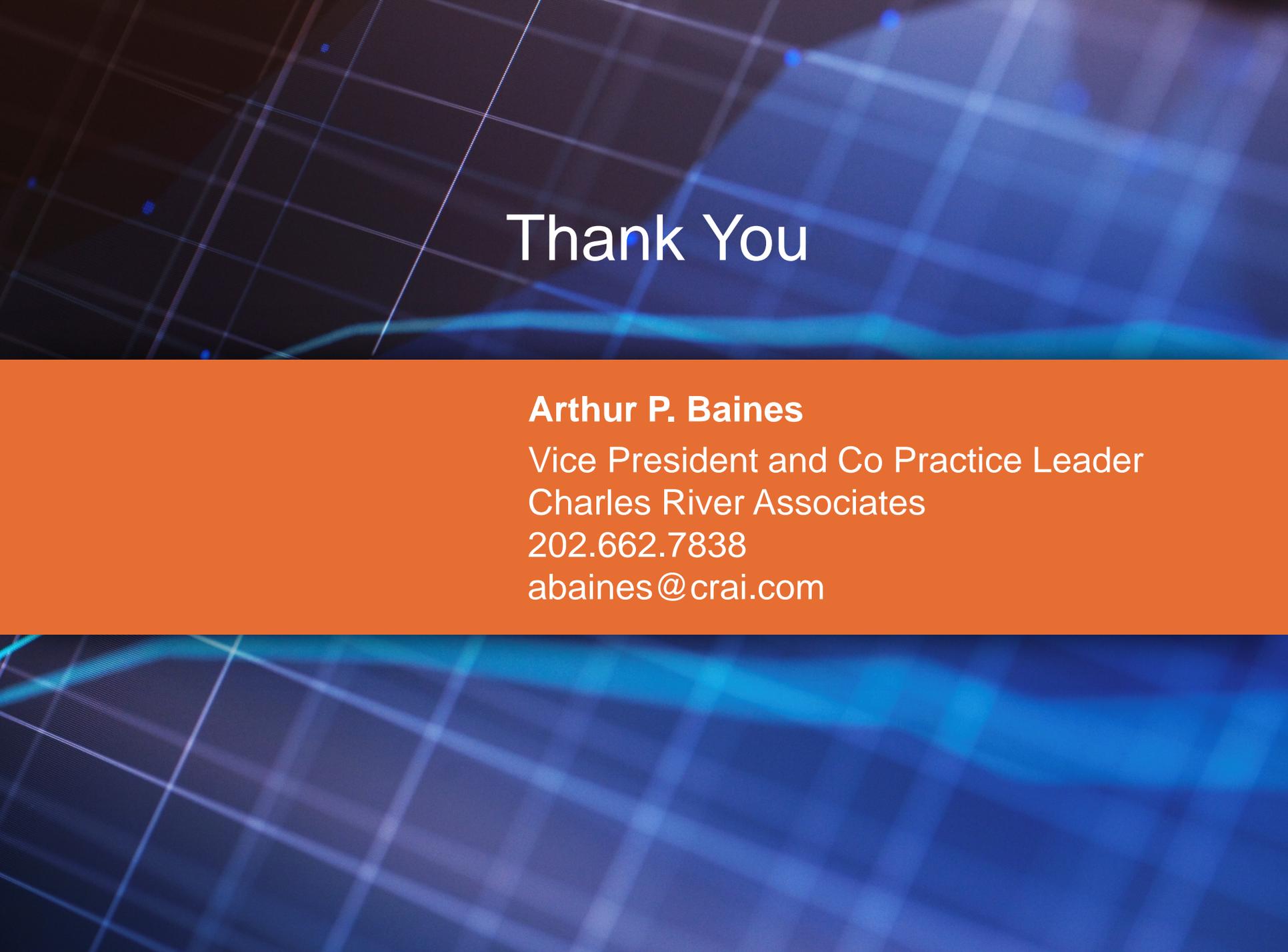
Fewer cases, but arguably stronger analytics from government

- Often accompanied by challenging optics

Less Disparate Impact and more:

- disparate treatment
- unfair, deceptive or abusive treatment

More sophisticated econometrics and analytics, requiring larger and more complicated data sourced from multiple systems



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CURRENT CONSUMER BANKRUPTCY REGULATORY ISSUES OF NOTE

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Bankruptcy notices = A continued focus of regulatory action

Payment Change Notices

Post-Petition Fee Notices

Notices of Final Cure

New focus on payment application

QC/QA of payment application in BK is critical especially as servicers work to address the CFPB's monthly statement requirements

System issues can have long term consequences

Monthly Statements

Payment application and monthly statements go hand and hand

Difficulties surrounding service transfer

Disagreements already with Chapter 13 trustees on servicers' obligations

Remediation of monthly statement errors will be challenging

Proofs of claim (POC)

Effective December 1, creditors must file POCs to have an allowed claim and POC filing deadline shortened to 70 days from petition date

Preparing an escrow statement as of the first post-petition month

Capturing transactions back to first date of delinquency

Loss mitigation

Reconciliation of fees, payment changes and payment application at time of loan mod

Failure to run escrow

PCNs for loan mods

Need for BK-compliant loss mit materials

Unsecured debt

Ability to identify amounts owed as of the petition date

Signing and filing

Statute of limitations

Other bankruptcy issues

Escrow

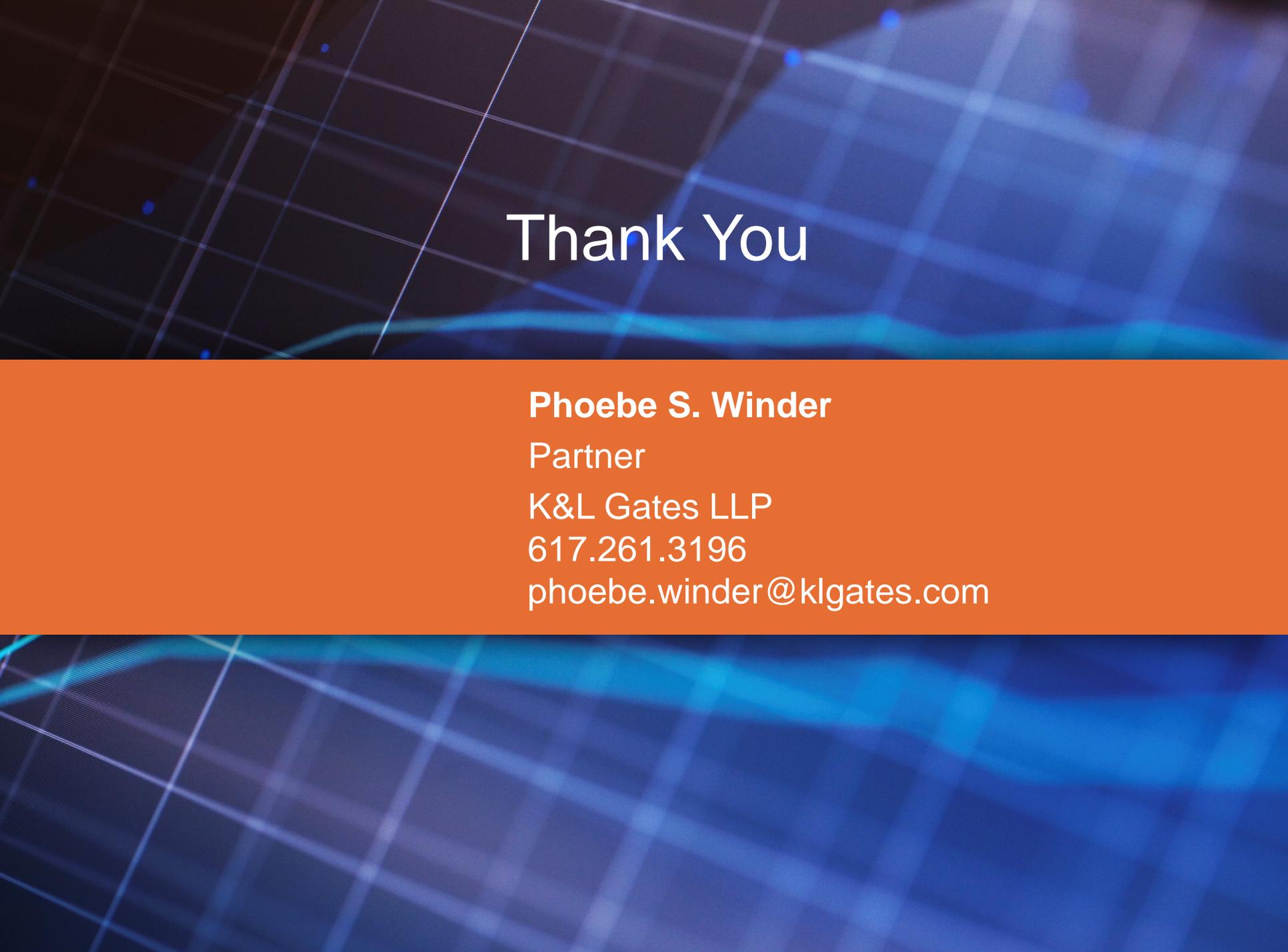
Redaction

- Remains an ongoing issue for regulators

Acquisition/Boarding

- Also a focus of regulators
- How much can you rely on prior servicer data?

Acceleration/Charge-Off



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FALSE CLAIMS ACT LIABILITY

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Mortgage-Related FCA Claims—The State of Play

- A tidal wave of Post-Financial Crisis False Claims Act cases involving FHA-insured mortgages
 - More than \$7 billion in Fines and Penalties
 - More than \$1.6 billion in Fine and Penalties in Fiscal 2016
- Fewer Cases and Overall Lower Mortgage-Related Fines in 2017
 - Substantial focus on “Crisis-era” conduct
 - Generally products of longstanding investigations
- U.S. v. Americus Mortgage Corp. (“Allied”) (S.D. Tex. (Sept. 2017) - FCA and FIRREA claims
 - Jury verdict in favor of government; \$292 million in damages and penalties (trebled); smaller (but additional) penalties under FIRREA
- Quicken continues to litigate with DOJ – Claims trimmed; discovery; Guild case – Motion to Dismiss pending

Recent Policy Statements Related to FCA Enforcement

- *“Yeah, well, we are already addressing that problem – our staff, along with the DOJ staff. And, we’re committed to getting that resolved because it’s ridiculous, quite frankly. And I’m not exactly sure why there had been such an escalation previously, but the long-term effects of that escalation is obviously providing fewer appropriate choices for consumers, and that’s exactly the opposite of what we should be doing.”*

HUD Secretary Ben Carson testimony before House Financial Services Committee on October 12, 2017, in response to a question about increased use of the FCA by DOJ/HUD to bring claims regarding asserted FHA-insured mortgage defects and the apparent reality that it has caused lenders not to participate in the program.

- *“We have heard concerns on the part of some in the lender community about participating fully in our programs because of the undue risks they perceive from a lack of clarity in what we expect and exposure to outsized liability from immaterial errors . . . I am very pleased to announce that HUD, in consultation with the Justice Department, is committed to reviewing and addressing these issues.”*

Remarks by Secretary Ben Carson at MBA Annual Conference, Oct. 23, 2017

FCA Liability – Continuing Uncertainty and Challenges

- FCA speaks in terms of “knowingly” presenting, or causing to be presented, “a false or fraudulent claim for payment or approval.” 31 U.S.C. §3729(a)(1)
 - “Knowledge” is defined as: (1) actual knowledge of the truth or falsity of the information; (2) acting in deliberate ignorance of the truth or falsity of the information; or (3) acting in reckless disregard of the truth or falsity of the information. 31 U.S.C. §3729(b)(1)
 - Proof of specific intent to defraud is not required; but, the “knowingly” standard excludes liability for innocent mistakes or negligence, even gross negligence
- **Materiality:** FCA is “not an appropriate vehicle for policing technical compliance with administrative regulations.” U.S. v. Southland Mgmt. Corp., 326 F. 3d 669, 682 (5th Cir. 2003)
- What is “**material**”: Lingering uncertainty; call for clarity regarding lender certifications and implementation of “defect taxonomy”



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