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LEGAL ISSUES BULLETIN

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Credit Union Capitalization of Interest to be Permitted as Part of Loan Workouts

Under longstanding language in 12 C.F.R. Part 741, Appendix B, a credit union loan workout policy must provide that the credit union may not authorize additional advances to finance unpaid interest and credit union fees. However, on June 24, 2021, the NCUA Board finalized its December 2020 proposal to make the following changes to Appendix B:

- The prior prohibition on the capitalization of interest in loan workouts and modifications is being removed, although the prohibition against additional advances to finance credit union fees and commissions will remain, and the new Appendix B language notes that capitalization of unpaid interest is appropriate only when the borrower has the ability to repay the debt.
- A definition for the term "capitalization of interest" (i.e., the addition of accrued but unpaid interest to the principal balance of a loan) is being inserted into the glossary.
- Where a loan workout policy permits modification of the loan to capitalize unpaid interest, the policy must require certain documentation, considerations, appropriate structuring for modifications, and other elements. Note this includes consideration of borrower options to repay missed payments at the end of their modifications to avoid delinquencies or other adverse consequences.

These measures (i.e., the removal of the prohibition on capitalization of interest and the addition of the accompanying protections where a workout policy permits capitalization) would apply to workouts of all types of member loans, including commercial and business loans.

The final rule is intended to both assist credit unions and their members in coping with difficult COVID-19/post-COVID-19 economic conditions and give credit unions parity with banks, Fannie Mae, Freddie Mac, and the Federal Housing Administration, all of which already allow servicers to capitalize interest in the context of loan modifications.

The final rule becomes effective 30 days following publication, so likely in August 2021.

NCUA Interpretation of CARES Act TDR Protection

CARES Act § 4013 contains an important protection for financial institutions, allowing lenders to avoid troubled debt restructure (TDR) treatment for loans impacted by COVID-19. However, recent examination reports have taken an interesting and counterintuitive interpretation of one of the § 4013 requirements. In short, while § 4013 requires that a loan be "not more than 30 days <u>past due as of</u> December 31, 2019," the NCUA has interpreted this section to only be available for loans <u>made before</u> December 31, 2019. Thus, loans originated in 2020 are interpreted to not have § 4013 protection available (though other TDR protections may apply). <u>This interpretation is not contained in the agencies' written guidance.</u> Our office continues to be in discussions with NCUA regarding this issue, but credit unions should be aware that this may impact their TDR treatment of specific loans.

CFPB Finalizes Mortgage Servicing Rules

The CFPB finalized new mortgage servicing rules on June 28, 2021, amending Regulation X under RESPA, to assist mortgage borrowers affected by the COVID-19 emergency. These Rules seek to help borrowers and servicers navigate the expected surge of borrowers exiting forbearance due at the end of assistance programs, including the foreclosure moratorium instituted by various federal housing agencies. Please note: this foreclosure moratorium was originally set to expire on June 30, however, it was recently extended to July 31, 2021.

The Rules provide new temporary safeguards through December 31, 2021. A servicer must make sure at least one of the three procedural safeguards has been met before referring accounts for foreclosure: 1) the property is abandoned; 2) the borrower is unresponsive; or 3) there was a complete loss mitigation application and the rules allow for foreclosure. Notably, these safeguards do not apply if: 1) the borrower was more than 120 days delinquent prior to March 1, 2020; or 2) the applicable statute of limitations for foreclosure will expire before January 1, 2022. The new safeguards will also not apply to first notices sent after January 1, 2022. For many mortgages under streamlined modifications or where there is some measure of contact, this can extend the foreclosure process through the remainder of the year.

The CFPB's Rules also aim to impose new protections for homeowners, focusing on communication with borrowers. Allowances for streamlined loan modification processes making it easier for borrowers with COVID-19-related hardships are further extended.

Please note that the effective date of the Rules is August 31, 2021. We anticipate that the CFPB will issue further guidance in the coming days and weeks.

Debt Collectors' FDCPA Bona Fide Error Defenses

In *Urbina v. Nati'l Bus. Factors Inc.*, the debt collector entered into a contract with its creditor client specifying that the creditor client would assign outstanding debts for collection with only accurate data and that the balances reflect legitimate, enforceable obligations of the consumer. However, the creditor client assigned a debt with an incorrect payment history, which resulted in the debt collector charging too much interest and attempting to collect more than was owed. In response, the debtor filed a complaint for violations of the FDCPA.

The debt collector opposed the complaint by asserting that it was entitled to the FDCPA's bona fide error defense. The bona fide error defense requires a showing by a preponderance of the evidence that the debt collector: (1) violated the FDCPA unintentionally; (2) the violation resulted from a bona fide error; and (3) the debt-collector-maintained procedures reasonably adapted to avoid the violation.

In *Urbina*, the first two factors of the bona fide error defense (i.e., unintentional violation and the violation resulting from a bona fide error) had previously been ruled in favor of the debt collector. However, the third factor (i.e., the sufficiency of procedures) was in dispute, and the court found that the debt collector's reliance on its clients was not a sufficient procedure.

To the extent that a financial institution is acting as a "debt collector" for another party, it cannot simply rely on contractual provisions requiring the creditor client to provide it with accurate information. Whether a procedure is sufficient for the bona fide error defense is a fact-intensive inquiry. Some examples of sufficient procedures include: (1) debt collector relied on account information provided by its client, but subjected it to an automated scrub that culled out-of-statute debts, the creditor client supplied an affidavit attesting to the accuracy of its information, and the debt collector's attorney verified the statute of limitations had not expired; or (2) a requirement that the creditor client verify under oath that each charge was accurate, the publication of an in-house FDCPA compliance manual (updated regularly and supplied to each firm employee), training seminars for firm employees collecting consumer debts, an eight-step, highly detailed pre-litigation review process to ensure accuracy and to review the work of firm employees to avoid FDCPA violations.

Financial institutions should be reviewing how they service loans that might be owned by a third party, but should also be reviewing whether any hired debt collectors are relying on insufficient procedures or potentially skirting FDCPA requirements.

California Court of Appeals Continues Trend of Holding PAGA Waivers Unenforceable

California courts have consistently held PAGA waivers unenforceable. In a recent unpublished opinion, a California appeals court continued this trend after rejecting Uber's attempt to enforce an arbitration provision requiring drivers to waive their right to bring an action under the California Private Attorneys General Act (PAGA). Under PAGA, "aggrieved employees" may file a lawsuit to recover civil penalties from employers for violations of the California Labor Code.

By way of background, Uber requires that all drivers enter into an agreement before becoming a driver which includes the arbitration provision in dispute. In the underlying lawsuit filed by the plaintiff in August 2018, the plaintiff alleged that Uber violated several Labor Code provisions due to it "willfully" misclassifying him as an independent contractor rather than an employee, thereby triggering his rights under PAGA. Uber responded by filing a motion to compel arbitration under the arbitration provision which was denied by the Los Angeles Superior Court.

On appeal, Uber argued that the threshold question of whether plaintiff was mischaracterized as an independent contractor was separate from the PAGA claim and therefore arbitrable. The appeals court disagreed and rejected Uber's argument stating that a PAGA claim is indivisible, belonging solely to the state. Accordingly, consistent with previous cases, a plaintiff cannot be forced to arbitrate any part of a PAGA claim.

The upshot: California courts will not allow any part of a PAGA claims to be arbitrated and employers must therefore be prepared to litigate all PAGA claims.

CFPB Delays Compliance Date for General QM Final Rule

You may recall that last year the CFPB issued the General Qualified Mortgage Final Rule which, among other things, redefined General QMs such that the 43% DTI ratio was removed in favor of price-based limits. While the Final Rule's effective date was March 1, 2021, compliance was not required until July 1, 2021. The CFPB recently delayed the compliance date to October 1, 2022. This effectively means that lenders have the option of using either the previous DTI based definition for General QMs or the revised price-based definition until October 1, 2022. Any applications accepted after October 1, 2022, will be required to use the revised definition.

550 N. Brand Boulevard, Suite 550, Glendale, CA 91203 Tel: (818) 241-0103
4695 Chabot Drive, Suite 200, Pleasanton, CA 94588 Tel: (925) 558-2739
swm.info@swmllp.com