ATTORNEYS AT LAW
SW&M

LEGAL ISSUES BULLETIN

June 2022

ATTORNEY-CLIENT PRIVILEGE – NOT TO BE CIRCULATED
FOR ADDRESSEE USE ONLY

California Supreme Court Holds Meal and Rest Break Premium Pay is Wages in California

On May 23, 2022, the California Supreme Court held that missed meal and rest break premium pay constitutes "wages" under California law. This long-awaited decision is an unfortunate blow to employers as California reiterates its employee-friendly stance; it will have a major impact on employers in California and increases potential liability for meal and rest break violations.

The Supreme Court noted that the lower court's "conclusion that premium pay cannot constitute wages rests on a false dichotomy: that a payment must be either a legal remedy or wages. [It] is both." The Supreme Court reasoned that missed-break premium pay serving as a remedy for a legal violation does not change the fact that the premium pay also compensates for labor performed "under conditions of hardship." Further, the Supreme Court concluded that "although the extra pay is designed to compensate for the unlawful deprivation of a guaranteed break, it also compensates for the work the employee performed during the break period."

This ruling will have significant ramifications as classifying missed-break premium pay as wages

(i) opens the door for waiting time penalties (if the premium pay is not timely paid); and
(ii) creates an obligation for employers to report premium pay for missed breaks in required wages statements (and the failure to report premium pay properly can result in statutory penalties).

California employers must be mindful of this ruling; enforce meal and rest period policies, and accurately report premium pay on wage statements to mitigate exposure to the increased risks for violations.

CFPB's 2021 Fair Lending Annual Report

The CFPB issued its annual fair lending report to Congress on May 6, 2022, which largely focused on addressing racial injustice, the emergence of innovative technologies in the financial services industry, and the long-term economic consequences of the COVID-19 pandemic.

Of note, the CFPB continued to prioritize promoting fair, equitable, and nondiscriminatory access to credit. The CFPB focused on fair lending issues related to, among others, mortgage origination and pricing, small business lending, student loan origination, policies and procedures regarding geographic and other exclusions in underwriting, and the use of artificial intelligence and machine learning models. In this regard, the CFPB opined that the future of the financial services industry would be increasingly shaped by predictive analytics, algorithms, and machine learning, and as such, the CFPB made it clear that one of its main focuses going forward will be analyzing digital redlining and algorithmic biases to identify emerging risks. Although the CFPB recognized the potential positive impact of these technologies for expanding access to credit, it noted that these technologies must be carefully crafted to avoid reinforcing historical biases that have improperly excluded consumers from various lending opportunities.

Accordingly, the CFPB acknowledged that predictive analytics, algorithms and machine learning technologies are not mistake-proof. These technologies are intended to remove the inherent biases that humans may have, but the CFPB appeared to be keenly aware of potential inherent biases merely being reinforced and masked through their use. With complex analytics and algorithms becoming more prevalent, financial institutions must remain mindful of fair lending issues. Of course, SW&M is always happy to assist with consumer compliance and fair lending needs, especially as related to the emergence of new technologies in the financial services industry.

DFPI Interpretations on Loan Purchases

The California DFPI has begun shifting positions on the interpretation of Financial Code § 14959, which regulates the purchase of whole loans or loan participations by California state-chartered credit unions. While the 2018 law that updated § 14959 intended "parity" with FCUs, recent interpretations by examiners have focused on purchases of loans where FinTech partners assist originating credit unions with the origination. As some of these loans are not assigned to the "originating" credit union until a time after funds are disbursed, the DFPI is questioning whether the credit union is "originating" the loan. This interpretation goes against an important 2015 NCUA legal opinion interpreting the same terms in NCUA rules regarding loan purchases and participations. Credit unions purchasing participations or whole loans from other credit unions, and credit unions partnering with FinTechs, need to be acutely aware of memberization and of the time between origination and assignment to the "originating" credit union. While credit unions are anxious to obtain new loans for diversification and interest income, such purchases can result in significant regulatory scrutiny if not supported by thorough due diligence and regulatory compliance measures.

Copyright © 2022

ATTORNEY-CLIENT PRIVILEGE – NOT TO BE CIRCULATED
FOR ADDRESSEE USE ONLY

Bank Held Liable for Agent's Negligence

The California Court of Appeals recently found Zions Bank liable for the mistake of its agent for service of process in dealing with a levy that applied to the funds of its account holder. Generally speaking, under California law, a financial institution must comply with a valid levy and deliver funds in its possession unless it has "good cause" to do so. In this case, Zions Bank's agent received the levy that named the account holder, but did not immediately forward the levy because it assumed that the notice applied to a different name on the levy that happened to be underlined. By the time the mistake was realized, the account holder had withdrawn most of the funds from the account. The court ruled that (1) the agent was negligent in not reading the levy and just assuming that the levy was directed to the person whose name was underlined, and (2) the law of agency and its agent's negligence prohibited Zions Bank from asserting the "good cause" defense to complying with the levy. As a result, Zions Bank was liable to the judgment creditor for the amount of funds that left the account after it would have otherwise frozen the account had it received the levy when served. This case serves as a good reminder to monitor the activity of your agents and to ensure that your agreements contain appropriate indemnification and hold harmless provisions to protect against the agent's negligence.

Congress Proposes Federal Privacy Legislation

Earlier this month, a draft bipartisan proposal for federal privacy legislation called the American Data Privacy and Protection Act (ADPPA) gained traction in Congress after years of congressional attempts to agree on comprehensive federal privacy legislation. The ADPPA would provide consumers more control over their online data and requires covered entities to minimize the amount of information they collect about consumers.

The ADPPA also includes a nuanced preemption provision that preempts state law but provides exemptions in an attempt to preserve various existing state privacy laws (or certain aspects thereof), including the Illinois Biometric Information Privacy Act (and other state facial recognition laws) and the private right of action under the CCPA. While there would be a private right of action under the ADPPA, it would only take effect four years after enactment.

While the ADPPA appears to be the closest Congress has gotten to passing federal privacy legislation, efforts appear to be somewhat stymied by the lack of support from Senate chair, Sen. Maria Cantwell (D-WA). Therefore, its future in this Congress is unclear. Stay tuned.

Access to Subchapter V and Chapter 13 Cases Expanded

During the height of the COVID-19 pandemic, the $2,725,625 debt limit (in existence at the time of the CARES Act) set forth in the Bankruptcy Code for subchapter V Chapter 11 cases (small business cases) was temporarily raised to $7.5 million and kept there through a series of extensions. The temporary provision expired on March 27, 2022. On June 21, 2022, President Biden signed S.3823, the "Bankruptcy Threshold Adjustment and Technical Corrections Act" into law. Among other things, the Act raises the debt limit for subchapter V Chapter 11 cases (small business cases) to $7.5 million for a period of two (2) more years. In addition, the Act raises the debt limit for Chapter 13 filings from $1,861,150 to $2.75 million for a period of two (2) years and removes the distinction between secured and unsecured debt for the threshold calculation. The higher debt limit for Chapter 13 cases also expires after two (2) years. The changes in the debt limits and the removal of the distinction between secured and unsecured debt for the threshold in Chapter 13 will allow more debtors access to each Chapter and may provide an impetus for some on-the-fence individuals and companies to file within the next two years instead of waiting. Financial institutions can therefore expect to see a mild to moderate increase in Chapter 13 filings due to the Act's changes alone over the next two years.

Coming Examination & Compliance Issues

In the current rapidly shifting interest rate environment, we are seeing increasing examination and audit findings regarding rate changes. As a reminder, loan documents with variable rates (5/1 ARMS, for example), must be properly recorded into software systems, as well as having applicable rate change notices provided. We frequently see issues arise when, among other triggers:

- Limits on rate changes are not recorded in software systems (e.g., rate changes will be at most 1%).
- Rate change notices are not properly coded into loan servicing software, and so are not compliant.
- Manually entered rates have errors.

The inflationary environment and rate increases that accompany them can significantly impact the scope of errors. In order to mitigate damages under TILA and satisfy regulatory expectations, error self-identification is important, and corrections generally require refund of interest or other finance charges over what was disclosed to the borrower. Accordingly, thorough audits early in this cycle will help minimize the consequences of any errors that might have occurred.

Copyright © 2022