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Legal Issues Bulletin

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Favorable Ruling in Zelle Class Action Litigation

There has been an increase in class action lawsuits involving financial institutions' Zelle services. Plaintiffs are alleging, among other things, breach of contract claims and violations of the EFTA and Regulation E. Bank of America, Wells Fargo, and Navy Federal Credit Union, among others, were all sued by consumers who claimed such institutions failed to reimburse class members for timely reported fraudulent losses incurred when using Zelle. These transactions were technically not "unauthorized electronic fund transfers" because it was not "initiated by a person other than the consumer," as required under Regulation E. These lawsuits appear to indicate that, even if a transaction is not subject to Reg. E, there may be exposure where Zelle is the method used for a fraudulent transaction and marketing suggests that the technology is "safe."

Having said that, a district court in New Jersey recently ruled favorably for financial institutions regarding such Zelle transactions. The court in *Wilkins v. Navy Federal Credit Union*, held that there was nothing unauthorized about the transaction at issue since the consumer admitted that she knowingly authorized the Zelle transaction. In other words, because Zelle was used to facilitate fraud, the court held that it did not mean the transaction was unauthorized, but rather, the member made a mistake. The *Wilkins* court ultimately dismissed the class action complaint.

This area of the law regarding Zelle and other P2P services and a financial institution's obligation to investigate alleged fraudulent transactions and/or reimburse account holders is still evolving and should be closely monitored. In the meantime, financial institutions should consider reviewing their consumer-facing documents and EFTA/Regulation E policies and procedures regarding fraudulent P2P transactions to ensure compliance with current laws and regulations.

Ninth Circuit Issues Win for Employers

Previously, our firm discussed AB 51, a 2019 law that sought to prohibit employers from requiring employees to execute an arbitration agreement as a condition of employment. However, before the law went into effect in 2020, a federal district court granted a preliminary injunction, enjoining enforcement.

After years of litigation, a three-judge panel for the Ninth Circuit, on February 15, 2023, issued a new opinion holding that AB 51 is preempted by the Federal Arbitration Act and is unenforceable. The panel reasoned that the "provisions of AB 51 work together to burden the formation of arbitration agreements" and is preempted "as a whole to the extent it applies to arbitration agreements."

The State of California may seek an appeal; however, this ruling is a win for employers and means that it is still lawful for employers to impose mandatory arbitration agreements as a condition of employment in California. Nevertheless, given the ever-changing legal landscape, employers should work with counsel to carefully draft such agreements.

CFPB Looks to Significantly Limit Late Fees

The CFPB recently proposed a rule to significantly limit late fees assessed on credit card accounts. Currently, Regulation Z generally limits penalty fees on credit cards to either 1) a fee that represents a reasonable proportion of the total costs incurred by the card issuer as a result of the type of violations (e.g., a late payment fee based on past delinquencies), or 2) a safe harbor amount set forth in Regulation Z that is adjusted annually by the CFPB to reflect inflation (currently, $30 or $41 for repeat penalties. In either case, a late fee may never exceed the amount of the required minimum periodic payment due.

The CFPB's proposed rule limits the safe harbor amount for late payment fees to $8 for both initial and repeat late payment violations. Additionally, the proposed rule would remove the annual inflation adjustment requirement, as the CFPB believes that such adjustments do not reflect the changes in the actual costs of collection experienced by card issuers. The proposal would also cap late fees at 25% of the required minimum periodic payment due. Thus, if the rule passes in its proposed form, for a card issuer to charge more than $8 for a late fee, it will have to be able to show that the excess represented a reasonable proportion of its costs incurred by having credit card payment delinquencies, and the minimum payment amount owed was more than $32. While cost accounting can show a lot about the true costs of activities, payment delinquencies will be difficult to trace through operations.

As part of the rulemaking process, the CFPB is seeking comment on whether the rule should apply to all "penalty" fees (not just late fees), whether the immunity provision should be eliminated altogether, whether there should be a 15 day grace period before a late payment fee could be charged, and whether card issuers should be required to offer autopay as a condition of being able to take advantage of the safe harbor. The comment period for this proposed rule closes on April 3, 2023. To the extent that any financial institutions have

cost accounting they can share with CFPB in that time period, it could be valuable to the industry.

NCUA Final Rule on Reportable Cyber Incidents

The NCUA adopted a final rule requiring federally insured credit unions to notify the NCUA no later than 72 hours after it reasonably believes that a reportable cyber incident has occurred or within 72 hours after being notified by a third-party of a reportable cyber incident, whichever is sooner.

The final rule defines a reportable cyber incident as "any substantial cyber incident" that causes (i) a substantial loss of confidentiality, integrity, or availability of a network or member information system as a result of unauthorized access to or exposure of sensitive data, disruption of vital member services, or that has a serious impact on the safety and resiliency of operational systems and processes, (ii) a disruption of a credit union's business operations, vital member services, or a member information, or (iii) a disruption of a credit union's business operations or unauthorized access to sensitive data either facilitated through, or caused by, a compromise of a credit union service organization, cloud service provider or other third-party data hosting provider or supply chain compromise.

The final rule is effective on September 1, 2023, and the NCUA will provide reporting guidance before the effective date.

New Guidelines for Using Criminal History

Section 205(d) of the Federal Credit Union Act prohibits credit unions from employing any person who has been convicted of or entered into a pretrial diversion program in connection with, any criminal offense involving dishonesty or a breach of trust without prior written consent from the NCUA Board. Violations can result in significant fines, or even prison time. In December 2022, changes to these standards were codified, partially expanding on prior NCUA guidance.

Prior NCUA guidance required a five-element test for an applicant's offense to be *de minimis* such that they would not require NCUA consent for employment. These include consideration of the number of offenses, their age, the possible and actual punishments for them, and other factors. Further, NCUA identified certain offenses that automatically qualify as *de minimis*.

As of January 1, 2023, the revised § 205(d) exceptions now include: (i) certain older offenses; (ii) convictions that have been expunged and sealed; and (iii) *de minimis* offenses. For the most part, the new codified exceptions mirror those provided by NCUA. There are, however, some notable differences. For example, unlike the NCUA guidelines, the age of the offenses alone (i.e., without considering the other *de minimis* criteria), can exempt a conviction from requiring NCUA consent. Also, for offenses committed under 21 years of age, the NCUA requirement for time to have been served prior to application is not a necessary component. For offenses involving bad checks, the new law's exemption where the total is less than $2,000 doubles the NCUA's prior threshold. Perhaps the biggest expansion is the new exemption for offenses punishable by three years or less, as opposed to the NCUA's prior rule of only one year or less. Finally, the law lists additional designated offenses that are exempt, including: use of a fake ID, shoplifting, trespass, fare evasion, and driving with an expired license or tag. We anticipate an updated IRPS from the NCUA in the future.

While the revised Section 205(d) further exempts certain offenses from the consent requirement, credit unions are not required to employ individuals who have been convicted of a *de minimis* or otherwise exempted offense. The expanded exceptions, however, will allow credit unions to hire individuals who are otherwise qualified without needing consent from the Board due to a conviction.

CFPB Issues Advisory Opinion on RESPA

The CFPB recently issued an Advisory Opinion to address the applicability of RESPA Section 8 to internet comparison shopping for real estate settlement services, including platforms that generate potential leads for the platform participants through consumers' interaction with the platform. These comparison shop platforms allow consumers to search for and compare options for mortgages or related services. If consumers input contact information as part of their search, the platform operator may share or sell this information to settlement service providers. This Advisory Opinion, the first issued by the CFPB on online lead generation, highlights several key compliance considerations.

RESPA's anti-kickback rules generally prohibit giving or receiving "any fee, kickback or other thing of value" for services involving a federally related mortgage loan. Referral fees are among the prohibited kickback fees.

If a platform provides enhanced placement or otherwise steers consumers to platform participants based on compensation the platform operator receives from those participants rather than based on neutral criteria, then the Opinion describes that as a violation. Specifically, the CFPB states that a platform receives a prohibited referral fee in violation of RESPA when: (i) the platform non-neutrally uses or presents information about one or more settlement service providers participating on the platform; (ii) such non-neutral use or presentation of information has the effect of steering the consumer to use, or otherwise affirmatively influences the selection of, those settlement service providers, thus constituting referral activity; and (iii) the operator receives a payment or other thing of value that is, at least in part, for that referral activity. Furthermore, if an operator of a platform receives a higher fee for including one settlement service provider compared to what it receives for including others participating on the same platform, that can be evidence of an illegal referral fee arrangement.

The Advisory Opinion provides several examples of online lead generation conduct that may violate RESPA. Financial institutions should carefully review the Advisory Opinion and the CFPB's guidance to ensure compliance, as payment or receipt of kickbacks in violation of RESPA Section 8 potentially carries criminal as well as financial penalties.