The Lender's Source

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Roll-Overs Granted New Permanent Relief from FinCEN Beneficial Ownership Rule

The Financial Crimes Enforcement Network's Beneficial Ownership Rule, which became effective May 11, 2018, requires an institution to identify and verify the identities of a legal entity's beneficial owners each time the entity opens a new account (whether a deposit or credit relationship) at the institution. Per FinCEN guidance, each renewal or roll-over of a preexisting certificate of deposit, loan, or line of credit was to be treated as a new account.

To accommodate many financial institutions' implementation concerns, FinCEN granted a series of temporary exemptions from the rule for automatic renewal or roll-over features of loans and certificates of deposit. On September 7, 2018, shortly before expiration of the final temporary exemption, FinCEN issued a ruling granting permanent relief for certain roll-overs and renewals.

Per the ruling (FIN-2018-004), beneficial owner identification and verification are not required for the following:

- roll-over of a certificate of deposit;
- renewal, modification, or extension of a loan, commercial line of credit, or credit card account where underwriting review and approval are not required; and
- renewal of a safe-deposit box rental.

Identification and verification continue to be required when the account is first created. In other words, the ruling only provides relief for certain renewal and roll-over events occurring after the initial opening of the account. And again, relief is limited to events that do not require underwriting review and approval. Thus, most loan modifications and renewals will be unaffected by the ruling, with completion of identification and verification processes continuing to be necessary.

Court Affirms Sizeable Punitive Damages Award Against Mortgage Servicer

In the recent opinion of *McGinnis v. American Home Mortgage Servicing,* the U.S. Court of Appeals for the Eleventh Circuit upheld a jury's punitive damage award of $3 million against a mortgage servicer for improper practices related to a single mortgage loan. The award was upheld despite the finding that the borrower only incurred $6,000 in economic loss as a result of the servicer's actions.

The borrower at issue owned several residential rental properties that she relied upon for income. Some time after she refinanced mortgage loan on one of the properties, the servicing rights on the loan was transferred to American Home Mortgage Servicing (now known as Homeward). In October of 2009 Homeward sent the borrower a "welcome letter" stating that the required monthly payment on the loan was to immediately increase to $843 per month (previously $605 per month) with no explanation for the increase. The borrower sent a notice of dispute to Homeward, and continued regularly paying $605 monthly.

Weeks after receiving the notice of dispute, Homeward sent the borrower an escrow analysis showing the increased payment amount was required to accommodate a larger escrow deposit. However, Homeward subsequently notified the borrower that its escrow analysis may have been in error and should be disregarded. Finally, in February of 2010 Homeward sent the borrower a new escrow analysis stating the monthly payment should have been $843 per month from November 2009 through March 2010, with the payment decreasing to $638 per month thereafter. The borrower responded in writing with her own escrow analysis showing Homeward's figures were in error with respect to the $843 payment demands.

Homeward refused to retract or further justify its calculations, and throughout the process routinely (and at times aggressively) contacted the borrower by phone and mail to demand payment. The borrower would later testify that the volume of collection letters she received from Homeward during the process reached a height of five feet when stacked together. The borrower continued paying $605 per month regularly. Importantly, Homeward

did not promptly credit these payments to the loan. Instead, it held the borrower's payments in a suspense account and only applied money to the loan when the account balance was sufficient to satisfy the oldest past-due payment in full. Interest continued to accrue as usual on the unpaid principal balance, and Homeward continued to impose a late fee for each new payment becoming past due. Eventually, in February of 2011 began rejecting further payments from the borrower. Homeward then foreclosed on the property.

The borrower filed suit against Homeward in the U.S. District Court for the Middle District of Georgia on the basis of wrongful foreclosure, conversion, interference with property, and intentional infliction of emotional distress. At trial, the borrower presented evidence that Homeward's actions caused her to suffer severe stress and depression, with resultant physical symptoms such as nausea and vomiting. She also presented copies of correspondence and recordings of telephone conversations with Homeward, during which she expressed frustration and stress at Homeward's continued refusal to correct its erroneous calculations.

Homeward presented only one witness, a default case manager for Homeward, who testified that the borrower should have paid the amount demanded regardless of whether it was erroneous or unreasonable. Homeward made no attempt to justify its escrow calculations.

The jury awarded the borrower a total of $3,506,000 in damages, comprising $6,000 for her economic loss; $500,000 for her emotional distress; and $3,000,000 in punitive damages. Homeward requested a new trial, arguing the punitive damages were impermissibly large. The trial court denied the request, and Homeward appealed.

On appeal, the U.S. Court of Appeals noted that in most instances Georgia law imposes a maximum limit of $250,000 on any punitive damages award. However, where the jury finds that the defendant (here, Homeward) acted with "specific intent to harm" this cap is removed. The U.S. Constitution also protects from excessively large punitive awards, but the appropriate limitation is judged on a case-by-case basis considering facts such as reprehensibility of the defendant's conduct.

The court held the jury had ample evidence to find that Homeward acted with specific intent to harm, and that Homeward's conduct was particularly reprehensible. Homeward knew its escrow calculations were erroneous. Despite this knowledge, and despite the borrower's good faith attempts to communicate the error, Homeward aggressively pursued the borrower for the erroneous balance and ultimately foreclosed on the property to recover it. Homeward behaved indifferently to the stress caused to the borrower and the potential loss of income she could suffer from the wrongful foreclosure. The court also held that use of the suspense account was "intentional malice, trickery, or deceit" as it allowed Homeward to collect additional late fees and interest from the borrower to which Homeward knew it was not properly entitled.

Given Homeward's indifference to harm caused by its actions, and the level of reprehensibility of its actions, the jury's award of $3,000,000 in punitive damages was lawful and was upheld by the court.

Regulatory Reform Legislation Resurrects the Protecting Tenants at Foreclosure Act

The Economic Growth, Regulatory Relief, and Consumer Protection Act, which was signed into law on May 24, 2018, was largely promoted as a source of regulatory relief for the financial industry. As one may expect, not all components of the Act are devoted to loosening restriction.

Notably, the Act resurrects the Protecting Tenants at Foreclosure Act of 2009, which had previously expired by its own terms (through a sunset provision) in December of 2014. The purported intent of that act was to provide tenants with sufficient time to find substitute housing in the event of foreclosure upon (and potential eviction from) a rented residence.

It is helpful to understand that the 2018 legislation does not introduce a new or otherwise modified version of the 2009 Act. Instead, the 2018 legislation simply deleted the sunset provision from the Protecting Tenants at Foreclosure Act, leaving the original Act to spring back into place effective as of June 23, 2018. There is no longer any sunset provision in the Act whatsoever, meaning it will be effective indefinitely.

Foreclosing lenders must once again familiarize themselves with the notice requirements and lease termination restrictions imposed by the Protecting Tenants at Foreclosure Act. In summary, after completion of foreclosure the foreclosure sale purchaser must provide a residential tenant with at least 90 days' notice, measured from the date the notice is given, to vacate the foreclosed premises. Further, in the event the tenant is a party to a bona fide lease that was entered into before the foreclosure sale, the tenant must be permitted to remain in the property throughout the stated lease term (subject to the default and other provisions of the lease, of course). If, however, the property is sold to a purchaser for occupancy as his or her primary residence, the lease may be terminated on 90 days' notice to the tenant.

As before, the Protecting Tenants at Foreclosure Act does not cover homeowners remaining in the residence after foreclosure and does not cover tenants facing eviction from a non-foreclosed property. The Act's coverage is also limited to "bona fide" tenants and leases, meaning leases to parents, children, or spouses of the mortgagor, or leases given on other than an arms-length basis, are not protected and will be subject to termination in accordance with applicable state law.

Understanding the UCC-1: *Accounts* and *Deposit Accounts*

When preparing security agreements and financing statements, it is important to understand the distinction between *deposit accounts* and *accounts* as those terms are used and defined in the secured transactions article (Article 9) of the Uniform Commercial Code.

The term *deposit account* has a fairly straightforward definition, meaning any demand, time, savings, passbook or similar account maintained with a bank. The term *account* is much broader, and includes most rights to payment of a monetary obligation. However, the UCC definition expressly excludes deposit accounts, as well as investment property, chattel paper, and rights to payment of a check or note, from the definition of *account*. In other words, a deposit account is not actually an *account*.

The obvious result of this curious set of definitions is that use of the term *account* in a security agreement or UCC-1 financing statement will not be effective to convey or perfect a security interest in the debtor's deposit accounts. If deposit accounts are to be included in a security agreement, the specific term *deposit accounts* must be used.

With respect to financing statements, the terms *account* and *deposit account* have another important distinction. Unlike security interests in accounts, a security interest in a deposit account cannot be perfected by filing a financing statement. Perfection can only be achieved by the secured creditor obtaining "control" of the deposit account using one of the methods prescribed by the UCC.

There are three ways in which a secured creditor may validly obtain control of a deposit account. First, if the secured creditor is the bank at which the deposit account is maintained, that creditor automatically has control. So in other words, when a lender obtains a security interest in its debtor's deposit accounts maintained with the lender, the lender is automatically perfected. Second, the secured creditor may enter into a written control agreement with the debtor and the bank at which the deposit account is maintained whereby the bank agrees to comply with the creditor's disposition instructions without further consent of the debtor. Finally, the creditor may itself become a customer of the bank (i.e., a co-accountholder) with respect to the deposit account. If one of these three methods is not used, any security interest the creditor may have in the deposit account (except to the extent the deposit account is proceeds of other original collateral) will not be perfected.

Have questions? Need help?

Moore, Clarke, DuVall & Rodgers, P.C. has attorneys available to provide representation throughout a broad range of concerns an institution may face. Our practice includes document preparation for complex loans and workout arrangements, bankruptcy and collection litigation, foreclosures, real estate transactions, taxation, estate planning, and employer representation in wage, hour, and discrimination disputes. The firm has attorneys licensed in Georgia, Florida, Alabama, South Carolina, and Tennessee. Please contact us to see how we can help.

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