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WHAT'S INSIDE

COMMENTARY

Stress tests: Making sure the large banks can weather another storm

Attorney Greg Bader of Florida-based law firm Gunster discusses the requirement of the Dodd-Frank Wall Street Reform and Consumer Protection Act that large banks undergo stress testing to determine whether they can withstand another financial crisis.

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BREACH OF CONTRACT

Debt relief company run by lawyers is a scam, suit says

A Washington couple has filed a class-action complaint against several debt relief companies connected to a law firm for allegedly bilking homeowners looking to restructure their mortgage debt.

Friel et al. v. Legal Helpers Debt Resolution LLC et al., No. 13-2-06414-6, complaint filed (Wash. Super. Ct., King County Feb. 22, 2013).

The complaint, filed by James A. and Deborah L. Friel in Washington's King County Superior Court, alleges Nevada-based Legal Helpers Debt Resolution took a retainer payment in exchange for helping them with their mortgage, but never followed through.

The Friels additionally name as defendants Arizona-based American Platinum Financial Services Inc. and Washington-based The Mortgage Law Group Inc., which they claim worked in concert with attorneys at the Illinois firm Macey, Aleman, Hyslip & Searns to scam Washington residents.

Individual defendants Thomas G. Macey, Jeffrey J. Aleman, Jeffrey Hyslip and Jason Searns are all principal agents of Legal Helpers Debt Resolution and The Mortgage Law Group, according to the suit.

The complaint additionally names as defendants Joseph Comprone, CEO of American Platinum and vice president of operations for the Macey law firm, and American Platinum director Christopher Sauer.

The Friels say they bought their home in Pierce County, Wash., in the early 1990s with a mortgage through nonparty Countrywide Home Loans,

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Stress tests: Making sure the large banks can weather another storm

By Greg Bader, Esq.,
Gunster

Have you ever had a stress test to see how your heart is functioning under pressure? Well, large banks are being required to go through something conceptually similar. Stress tests are designed to assess whether certain larger institutions have sufficient capital to maintain their lending operations if we have another significant economic downturn such as that which occurred in 2007.

Stress tests were put in place as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. 1376, and showed the disappointment of Congress with the performance (or lack thereof) of the country's financial institutions through such harsh times. At the time, Congress expressly declared that the Dodd-Frank Act served "to promote the financial stability of the United States by improving accountability and transparency in the financial system."[1]

Essentially, in the eyes of Congress, the financial meltdown established that institutions that are unsuspecting of traumatic events can suffer serious threats to their financial condition and viability. Thus, stress tests are intended to make these institutions and their regulators more aware of potential problems before a crisis occurs.

To address this pointed issue, the Dodd-Frank Act contains numerous provisions aimed at enhancing supervision and prudential standards for bank and non-bank financial companies. One such provision, Section 165, imposes requirements for non-bank financial companies supervised by the board of governors of the Federal Reserve and certain banks and bank holding companies.[2] Specifically, with regard to ensuring that institutions have adequate capital to absorb losses and support operations during unfavorable economic conditions, Section 165(i) mandates the Federal Reserve and/or the relevant companies to conduct stress tests so that the Federal Reserve and, more importantly, the companies may better assess risk and be better equipped to address a range of adverse outcomes.

> Stress tests are intended to make these institutions and their regulators more aware of potential problems before a crisis occurs.

Under the regulations required to implement Section 165(i) of the Dodd-Frank Act issued by the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corp., a stress test is a process that assesses the potential impact of hypothetical economic conditions (known as scenarios) on the consolidated earnings, losses and capital of a covered institution over a set period (called the planning horizon). This test takes into account the current condition of the covered institution, including its risks, exposures, strategies and activities.[3]

In the midst of the financial crisis, and notably before the enactment of Dodd-Frank, the Federal Reserve, along with other federal financial regulatory agencies, conducted stress tests of large, complex bank holding companies through the Supervisory Capital Assessment Program, or SCAP. It was one of several efforts taken to stabilize the U.S. financial system during that time.

The SCAP, a forward-looking exercise designed to estimate revenue, losses and capital needs under an unfavorable economic and financial market scenario, is said to have provided valuable information to market participants, reducing uncertainty about the financial condition of the participating bank holding companies and restoring investor and consumer confidence thereby. Notably, using the results of these stress tests, the Federal Reserve forced the 10 banks that failed to increase their financial cushions against potential losses by $74.6 billion collectively. And further, since then, the Federal Reserve has made the test results a factor in its decision each year on whether to let large banks return cash to shareholders.[4]

THE MANDATE OF DODD-FRANK

The Dodd-Frank Act charges the Federal Reserve with the responsibility for implementing the mandate(s) issued by Section 165.[5] On Oct. 9, 2012, the Federal Reserve published the two final rules implementing Sections 165(i)(1) and 165(i)(2), noting that "implementation of the Dodd-Frank stress test requirement is an important step in the Federal Reserve's efforts to promote the health of the financial sector."[6] In enacting these final rules, the Federal Reserve coordinated closely with the OCC and the FDIC to ensure that final rules issued by these agencies on stress testing are consistent and comparable with each other as well as with those of the Federal Insurance Office.[7]

Greg Bader, a shareholder at **Gunster** in Fort Lauderdale, Fla., leads the firm's banking and financial services practice. He concentrates on mergers and acquisitions, corporate finance and capital market transactions, Securities and Exchange Commission compliance, and consumer finance and lending law. He can be reached at gbader@gunster.com.

Bank holding companies and non-bank financial companies

Under the Federal Reserve's final rules, bank holding companies with total consolidated assets of $50 billion or more and non-bank financial companies that the Financial Stability Oversight Council has designated for supervision by the Federal Reserve (each a "covered company") will undergo annual supervisory stress tests as well as annual and semi-annual company-run stress tests. The 19 bank holding companies that participated in the SCAP (or successors to such bank holding companies) must comply with both testing mandates for the stress-test cycle that commenced Nov. 15, 2012.[8] Those bank holding and non-bank financial companies that became subject to the requirements by the publication of the final rules implementing Section 165(i)(1),(2) must comply with the mandates for the stress-test cycle that commences on Oct. 1, 2013, unless this deadline is extended by the Federal Reserve.[9]

Each covered company must conduct its annual stress test by Jan. 5 during each stress cycle and must use the scenarios provided by the Federal Reserve.[15] Each covered company must conduct its mid-cycle stress test by July 5 and must develop and employ a minimum of three scenarios, including a baseline scenario, an adverse scenario and a severely adverse scenario, that are appropriate for its own risk profile and operations.[16] In conducting each of these stress tests, each covered company must estimate, for each scenario required to be used, losses, pre-provision net revenue, provisions for loan and lease losses and net income, and the potential impact on pro forma regulatory capital levels and pro forma capital ratios. The covered company must also incorporate the effects of any capital actions over the planning horizon and the maintenance of an allowance for loan losses appropriate for credit exposures throughout the planning horizon.[17]

> Before the enactment of the Dodd-Frank Act, the Federal Reserve conducted stress tests of large, complex bank holding companies through the Supervisory Capital Assessment Program.

When the Federal Reserve conducts stress tests, its analytical techniques will be used to identify, measure and monitor the risks of each covered company that may affect the financial stability of the United States.[10] Essentially, the Federal Reserve will evaluate the ability of each covered company to absorb losses in specified economic and financial conditions using a minimum of three different scenarios: a baseline scenario, an adverse scenario and a severely adverse scenario.[11] The analysis will include an assessment of the projected losses, net income, and pro forma and regulatory capital ratios, tier 1 common ratios and other capital ratios for the covered company.[12] To assist the Federal Reserve with its analysis, covered companies must submit such data that the Federal Reserve deems necessary in order to conduct the analysis.[13] The Federal Reserve will convey the results of its testing to each covered company within a reasonable period of time, but no later than March 31.[14]

Banking organizations that are not covered companies

Also, under the Federal Reserve's final rules, bank holding companies with total consolidated assets between $10 billion and $50 billion and savings and loan holding companies and state member banks with total consolidated assets of more than $10 billion will undergo annual company-run stress tests. The bank holding companies and state member banks that met the asset threshold on or before Dec. 31, 2012 must comply with the mandate for the stress-test cycle that commences on Oct. 1, 2013, unless the deadline is extended by the Federal Reserve.[18]

Bank holding companies and state member banks that meet the asset threshold after Dec. 31, 2012, must comply with the requirements beginning with the stress-test cycle that commences in the calendar year after the year in which the company meets the asset threshold.[19]

Savings and loan companies must comply with the requirements beginning with the stress-test cycle that commences in the calendar year after the year in which the company becomes subject to the Federal Reserve's minimum regulatory capital requirements, unless the deadline is extended.[20]

Savings and loan companies with average total consolidated assets of $50 billion or more and state member banks that are subsidiaries of covered companies must conduct annual stress tests by Jan. 5 of each calendar year based on data as of Sept. 30 of the preceding calendar year.[21] Banking holding companies, savings and loan companies with total consolidated assets of less than $50 billion and state member banks that are not covered company subsidiaries must conduct annual stress tests by March 31 of each calendar year using financial statement data as of Sept. 30 of the preceding calendar year.[22] Generally, these entities must use scenarios provided by the Federal Reserve, which will be provided no later than Nov. 15 of the relevant calendar year.[23]

In conducting these stress tests, each of these entities must estimate, for each scenario required to be used, losses, pre-provision net revenue, provisions for loan and lease losses and net income, and the potential impact on pro forma regulatory capital levels and pro forma capital ratios. These entities must also incorporate the effects of any capital actions over the planning horizon and the maintenance of an allowance for loan losses appropriate for credit exposures throughout the planning horizon.[24] The senior management of these entities must establish and maintain a system of controls, oversight and documentation, including policies and procedures, that are designed to ensure that their stress-testing methods are effective in meeting the requirements of the mandate.[25] Further, the boards of directors of these entities must consider the results of the tests in the normal course of business, including but not limited to the organization's capital planning, assessment of capital adequacy and risk management practices.[26]

DISCLOSURE

A summary of the supervisory results and analysis of covered companies will be published by the Federal Reserve by March 31 of the calendar year. Covered

companies must disclose summaries of the results of their annual company-run stress tests between March 15 and March 31 of the calendar year[27] and of their mid-cycle company-run stress tests between Sept.15 and Sept. 31.[28] Such summaries will include, among other requirements, a description of the types of risks included in the test and a general description of the methodology used.[29]

> The Federal Reserve will evaluate the ability of each covered company to absorb losses in specified economic and financial conditions.

Banking organizations with total consolidated assets of more than $10 billion that are not covered companies must, generally, disclose a summary of the results of their mandated company-run tests between June 15 and June 30.[30] Notably, those bank holding companies, savings and loan holding companies or state member banks with total consolidated assets of less than $50 billion on or before Dec. 31, 2012, do not have to comply with these disclosure requirements until the stress-test cycle that commences on Oct. 1, 2014.[31]

Generally, disclosure by these financial institutions can occur by publication on the organization's website or in any other forum that is reasonably accessible to the public.[32]

CONCLUSION

The stress tests mandated by Section 165(i) of the Dodd-Frank Act expand the stress-testing process that was already in place for the largest banks and add testing for banks with more than $10 billion in assets. Such expansion represents acceptance by Congress that the systemic risk generally associated with larger financial institutions is equally applicable for smaller and mid-size regional financial institutions. Although the mandate of the Dodd-Frank Act applies only to financial institutions with more than $10 billion in assets, regulatory agencies such as the OCC are taking the position that all banks, regardless of size, should have the capacity to analyze the potential impact of adverse outcomes on their financial conditions.[33]

Essentially, despite the recent stabilization in the U.S. capital markets and the improving economic conditions, the capacity to sustain large loan losses and continue lending in a difficult economic environment remains a questionable prospect for large and small banking institutions alike. Therefore, financial institutions will need to continue focusing on their ability to weather another financial storm. WJ

NOTES

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1376 (2010).

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act § 165(i), 12 U.S.C. § 5365 (2010).

[3] 12 CFR Part 46.2; 12 CFR Part 325, Subpart C.

[4] Building on the SCAP and other supervisory work coming out of the crisis, the Federal Reserve initiated the annual Comprehensive Capital Analysis and Review in late 2010 to assess the capital adequacy and the internal capital planning processes of large, complex bank holding companies and to incorporate stress testing as part of the Federal Reserve's regular supervisory program for assessing capital adequacy and capital planning practices at large bank holding companies.

[5] Dodd-Frank Wall Street Reform and Consumer Protection Act § 165(a)(1), 12 U.S.C. § 5365 (2010).

[6] Press Release, Federal Reserve, Governor Daniel K. Tarullo (Oct. 9, 2012), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20121009a.htm.

[7] Section 165(i)(2)(C) directs each federal primary financial regulatory agency, in coordination with the Federal Reserve and the Federal Insurance Office, to issue consistent and comparable regulations to implement the stress-test requirements. Dodd-Frank Wall Street Reform and Consumer Protection Act § 165(i)(2)(C), 12 U.S.C. § 5365 (2010).

[8] 12 CFR Part 252.133(a)(2); 12 CFR Part 252.143(a)(2).

[9] 12 CFR Part 252.133(a)(1);12 CFR Part 252.143(a)(1).

[10] 12 CFR Part 252.134(a)(2).

[11] 12 CFR 252.134(b). The Federal Reserve will notify covered companies of the scenarios to be applied by no later than Nov. 15 of each year, except with respect to trading or any other components of the scenarios and any additional scenarios the Federal Reserve will apply, which will be communicated by no later than Dec. 1.

[12] 12 CFR 252.135(a)(2).

[13] 12 CFR 252.135(a).

[14] 12 CFR 252.136(b).

[15] 12 CFR 252.144(a), (b)(1).

[16] 12 CFR 252.145(a), (b)(1).

[17] 12 CFR 252. 146(a).

[18] 12 CFR Part 252.153. Notably, state-member banks that meet the asset threshold as of Nov. 15, 2012, and are subsidiaries of bank holding companies participating in the SCAP must comply beginning with the stress-test cycle that commences on Nov. 15, 2012. A U.S.-domiciled bank holding company that is a subsidiary of a foreign banking organization that is currently relying on Supervision and Regulation Letter SR 01-01 issued by the Federal Reserve must comply with the requirements for the stress-test cycle that commences on Oct. 1, 2015.

[19] 12 CFR 252.153(b).

[20] 12 CFR 252.153(c)(1), (2).

[21] 12 CFR 252.154(a)(1).

[22] 12 CFR 252.154(a)(2).

[23] 12 CFR 252.154(b)(1).

[24] 12 CFR 252.155(a)(1),(2).

[25] 12 CFR 252.155(c)(1).

[26] 12 CFR 252.155(c)(3).

[27] 12 CFR 252.148(a)(1)(i).

[28] 12 CFR 252.148(a)(1)(ii).

[29] 12 CFR 252.148(b)(1), (2).

[30] 12 CFR 252.157(a)(1). State member banks that are covered company subsidiaries or savings and loan holding companies with average total consolidated assets of $50 billion or more must disclose the summary between March 15 and March 31.

[31] 12 CFR 252.157(a)(2).

[32] *See* 12 CFR 252.148(a)(3); 12 CFR 252.157(3).

[33] *See*, *for example*, Bulletin OCC 2012-33, "Community Bank Stress Testing: Supervisory Guidance" (Oct. 18, 2012) (encouraging national banks and federal savings associations with $10 billion or less in total assets to use stress testing to identify and quantify risk in loan portfolios and to help establish effective strategic and capital planning processes).

Bank's ATM lacked fee notice, Illinois class action says

An Illinois man has sued Chicago-based First Federal Savings Bank for allegedly failing to post a notice on one of its automated teller machines to alert consumers that a fee would be assessed on transactions.

Stilz v. First Federal Savings Bank, No. 3:13-cv-50058, complaint filed (N.D. Ill. Feb. 20, 2013).

According to the class action complaint filed in the U.S. District Court for the Northern District of Illinois, Wallace Stilz III used a First Federal ATM in Amboy, Ill., Sept. 7, 2012.

Stilz claims the bank charged him a $2 fee to withdraw money, but there was no posted fee notice either on or near the machine, in violation of the Electronic Fund Transfer Act, 15 U.S.C. § 1693, and its implementing regulation, known as Regulation E, 12 C.F.R. § 205.1

Stilz allegedly returned to the machine one month later and found it was still out of compliance with the federal law.

Under the EFTA, operators of ATMs must post a notice on or near the machine that a fee will be assessed and either on the screen or by paper prior to any transaction taking place, according to the complaint. The notice must alert consumers not only to the fee, but also to the amount being charged, the suit says.

Stilz claims First Federal failed to adhere to the law for at least one year prior to Dec. 20, 2012. He is proposing a plaintiff class made up of all consumers who used the machine to make a transaction during that period.

REUTERS/Soe Zeya Tun

Stilz is seeking class certification, as well as an award of unspecified statutory damages, attorney fees and costs. WJ

Attorney:
Plaintiff: Raj Sanghvi, Chicago

Related Court Document:
Complaint: 2013 WL 625443

See Document Section B (P. 28) for the complaint.

NEWS IN BRIEF

FDIC TAKES ACTION AFTER GEORGIA BANK FAILS

The assets and deposits of the failed LaGrange, Ga.-based Frontier Bank have been moved to HeritageBank of the South in Albany, Ga., the Federal Deposit Insurance Corp. said in a March 8 statement. The FDIC arranged the transfer in its capacity as Frontier Bank's receiver after the Georgia Department of Banking and Finance acted on liquidity concerns and closed the institution. The failed bank had $258.8 million in assets and $224.1 million in deposits as of Dec. 31, according to the FDIC. Frontier Bank is the fourth institution to fail this year and the first iin Georgia.

OCC SAYS 34 BANKS MEET LOCAL LENDING GOALS

The Office of the Comptroller of the Currency said in a March 1 statement that out of 34 banks evaluated on local lending efforts, six banks have received ratings of "outstanding" and 28 institutions have been marked as "satisfactory." The ratings appear in the agency's latest report on banks' compliance with the Community Reinvestment Act. The CRA mandates that financial institutions serve the credit needs of low- and moderate-income customers in their neighborhoods and federal regulators must periodically assess how each bank is complying with these obligations. The six banks are the Milford Federal Savings & Loan Association in Milford, Mass.; First National Bank of Catlin in Catlin, Ill.; Worthington National Bank in Arlington, Texas; OceanFirst Bank in Toms River, N.J.; and two branches of Bremer Bank in South St. Paul, Minn., and Menomonie, Wis. The OCC's list of CRA evaluations is available at http://www.occ.gov/static/cra/feb13.html.

MORTGAGE MODIFICATION PROGRAM HAS HELPED 1.1 MILLION BORROWERS, REPORT SAYS

More than 1.1 million homeowners have received permanent loan modifications through the government's Home Affordable Modification Program as of January, according to a March 7 joint statement by the Treasury Department and the Department of Housing and Urban Development. The data is based on the Obama administration's "housing scorecard" for February. The scorecard, issued monthly, discusses the amount of new home sales and the effect of the administration's programs aimed at helping at-risk homeowners avoid foreclosure. The new scorecard is available at http://portal.hud.gov/hudportal/documents/huddoc?id=FebNat2013Scorecard.pdf.

Class action targets auto loan payment fees

A Pennsylvania woman has alleged in a proposed class-action lawsuit that her car loan creditors have added unauthorized fees to installment payments she made over the phone.

Novak v. Santander Consumer USA Inc. et al., No. 13-CV-1240, complaint filed (E.D. Pa. Mar. 7, 2013).

Leyna Novak says state law does not permit CitiFinancial Auto Corp. and its successor, Santander Consumer USA Inc., to assess fees that are not listed in her car sale contract.

She alleges the defendants violated the Pennsylvania Motor Vehicle Sales Finance Act, 69 Pa. Stat. § 601, by charging her either $10.95 or $14.95 each time she made a loan payment by phone.

In the complaint, which was filed in the U.S. District Court for the Eastern District of Pennsylvania, Novak says she bought a 2003 Mercury Mountaineer in September 2005 from nonparty Murphy Ford Co. for $25,823.

REUTERS/Mike Segar

The complaint says CitiFinancial representatives began calling the plaintiff to obtain her monthly car loan payment over the phone.

Novak says that between December 2006 and May 2010 she made 28 payments to CitiFinancial over the phone. The company charged her a $10.95 fee for each payment.

The plaintiff says Pennsylvania law does not permit auto loan servicers to assess fees that are not listed in her car sale contract.

Under the terms of the installment sales contract Novak agreed to six-year loan with a 14.49 percent interest rate and monthly payments of $358.66, the suit says.

Novak says at the time of her purchase Murphy obtained credit approval from CitiFinancial. Shortly thereafter Murphy assigned its rights under the sales contract, including the right to accept payments, to CitiFinancial, according to the suit.

Santander took over CitiFinancial's payment collection responsibilities sometime after May 2010 and in November 2010 contacted Novak to obtain her loan payments by phone, the complaint alleges.

Novak says she made 9 payments to Santander by phone between November 2010 and August 2011. She claims the company charged her a $14.95 fee for each payment.

The complaint alleges that under the Motor Vehicle Sales Finance Act vehicle sales contracts must list and itemize all the charges that a seller and its successors will receive from the buyer.

The MVSFA also says sellers cannot charge any fees over and above those listed, according to the suit.

Novak claims the defendants have imposed and continue to charge vehicle buyers improper fees on telephone and online payments in violation of the MVSFA.

She is seeking to represent a class of all people who bought vehicles in Pennsylvania under an installment sales contract who have been charged fees in connection with payments made by phone and online. The class period would run from March 2007 to the present, the complaint says.

In addition to class certification the plaintiff requests unspecified damages and an order directing the defendants to pay restitution to class members.

Novak is also asking for an award of attorney fees and costs. WJ

Attorney:
Plaintiff: Kenneth Jacobsen, Jacobsen Law Offices, Wallingford, Pa.

Related Court Document:
Complaint: 2013 WL 861590

See Document Section C (P. 32) for the complaint.

UBS ordered to participate in FINRA arbitration

A dispute over $475 million in auction-rate securities between Swiss financial services giant UBS and health care provider Allina Health Systems will be arbitrated by the Financial Industry Regulatory Authority, a Minnesota federal judge has ruled.

UBS Securities LLC v. Allina Health Systems, No. 12-2090, 2013 WL 500373 (D. Minn. Feb. 11, 2013).

UBS tried to avoid arbitration by arguing that Allina was not its customer, as defined by FINRA, but U.S. District Judge Michael J. Davis of the District of Minnesota disagreed and held that Allina was a customer and therefore could request mandatory FINRA arbitration.

According to the judge's order, UBS served as underwriter and lead broker-dealer for $475 million in auction-rate securities Minneapolis-based Allina Health Systems issued to refinance outstanding debt and remodel and upgrade its facilities.

The interest rate of the securities is reset periodically through an auction. This results in a long-term security with an overall lower interest rate than a more traditional long-term investment with a set interest rate.

UBS also advised Allina on interest-rate-swap agreements to hedge against the interest rates of the bonds.

In an interest-rate swap the debt issuer and a counterparty exchange periodic fixed-rate payments for variable-rate payments based on a changing market index.

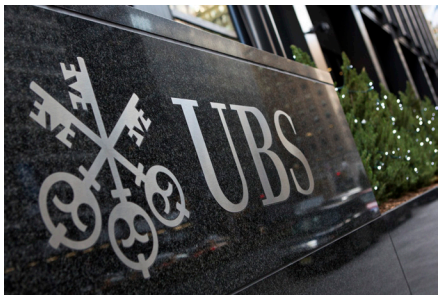
Pursuant to the securities transactions, UBS and Allina entered into a bond purchase agreement and a broker-dealer agreement, the order says.

The bond purchase agreement contained a forum-selection clause requiring that disputes be handled through the American Arbitration Association.

The forum-selection clause of the broker-dealer agreement required that adjudication of any dispute take place in a New York state court or the U.S. District Court for the Southern District of New York. FINRA arbitration could be conducted anywhere in the country.

The interest rates for adjustable-rate securities began increasing in October 2007, causing Allina to lose money on its payments to the interest-rate-swap counterparty, the order says.

Due to changing market conditions, Allina was forced to refinance the securities at a significant cost and to get expensive letters of credit, according to the order.



REUTERS/Andrew Burton

Rather than file a claim in either New York state or federal court, Allina filed a statement of claim to begin FINRA arbitration as a customer of UBS, a FINRA member. UBS, in turn, filed for a preliminary injunction in the Minnesota federal court to prevent FINRA arbitration.

Under FINRA rules, arbitration is available to "customers" of FINRA members if it is requested, the order says.

UBS argued that Allina was not a customer under FINRA rules and therefore not entitled to FINRA arbitration. The FINRA rules define a "customer" as "not including a broker or dealer."

Judge Davis, following other courts' interpretations of "customer," found that Allina is a customer under FINRA. The judge defined a customer as one who is involved in a business relationship with a FINRA member directly related to investment or brokerage services and receives more than financial advice.

According to the order, Allina received more than financial advice from UBS relating to brokerage or investment services. UBS advised Allina on the issuance of the securities, served as the securities underwriter, was lead broker-dealer for the securities auctions, acted as Allina's agent with the rating services and sold Allina interest rate swap agreements, the judge said.

Alternatively, UBS argued that the forum-selection clauses in either the broker-dealer agreement or bond purchase agreement superseded any obligation to undergo FINRA arbitration, the order says.

Judge Davis disagreed, ruling that the forum-selection clause of the broker-dealer agreement did not supersede FINRA arbitration because the agreement did not sufficiently specify any express intent to waive a customer's right to FINRA arbitration.

The judge declined to determine whether the bond purchase agreement superseded FINRA arbitration because who arbitrates the dispute is a question to be answered in arbitration as opposed to the courts. WJ

Related Court Document:
Order: 2013 WL 500373

See Document Section D (P. 42) for the order.

World's largest banks prevent revival of antitrust suit

Some of the world's largest and best known financial institutions have won the dismissal of an antitrust class-action lawsuit alleging they caused the collapse of the auction-rate securities market in early 2008.

Mayor & City Council of Baltimore v. Citigroup et al., No. 10-0722-CV, 2013 WL 791397 (2d Cir. Mar. 5, 2013).

A three-judge panel of the 2nd U.S. Circuit Court of Appeals said the plaintiffs failed to adequately allege an antitrust conspiracy because the complaint provided inadequate support in that it only pointed to the defendants' simultaneous withdrawal from the ARS market as evidence of a conspiracy.

The defendants included Goldman Sachs, Morgan Stanley, Lehman Bros., Citigroup, Merrill Lynch, Wachovia, JPMorgan, Deutsche Bank and Royal Bank of Canada.

According to the panel's opinion, the plaintiffs sought relief on behalf of buyers and issuers of auction-rate securities.

An auction rate security is periodically traded at auctions. The interest rate of the ARS is reset at the auction depending on demand for the security. This results in a long-term security with an overall lower interest rate than a more traditional long-term investment with a set interest rate.

An auction succeeds only if demand for the securities matches or exceeds the supply of securities at auction. If the auction fails, the holder of the security is forced to continue holding it.

An "auction failure" penalizes the issuer by automatically triggering an increase in the interest rate pursuant to the securities offering documents to compensate the investor for not being able to exit its position.

According to the opinion, the plaintiffs allege that when the ARS market began deteriorating in 2007, the defendants began placing "support bids" to prevent auction failures. At the same time, the defendants were allegedly removing ARS en masse from their books and selling them to any and all investors, the opinion says.

By placing support bids, the plaintiffs claim, the defendants propped up the ARS market long enough for the defendants to discard the increasingly worthless auction-rate securities.

The suit said that after sufficiently transferring the risky securities to the plaintiffs, the defendants allegedly stopped placing support bids in a concerted manner, thus causing the ARS market to collapse in early 2008. As the ARS market still has not recovered, the plaintiffs are stuck with worthless securities that cannot be auctioned, the suit said.

The plaintiffs contended that the defendants' collective withdrawal from the ARS market constituted a "refusal to deal" and a "boycott" in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

The U.S. District Court for the Southern District of New York dismissed the complaint on the grounds that it failed to allege a securities law violation.

The 2nd Circuit affirmed the District Court's decision on different grounds, not reaching the securities law ruling. The panel instead found that the plaintiffs' complaint fell short of a sufficient claim that the defendants violated antitrust law because it only described their parallel conduct and nothing more.

According to the court, the departure from the ARS market by the defendants was a business decision made by each individual defendant independent of one another.

> The plaintiffs argued that the defendants' collective withdrawal from the ARS market constituted a "refusal to deal" and a "boycott" in violation of the Sherman Act.

The decision to flee the ARS market in early 2008 was "not just *a* rational business decision, but the *only* rational business decision," the court said.

Moreover, the additional facts pleaded by the plaintiffs failed "to suggest that this parallel conduct flowed from a preceding agreement rather than from [the defendants'] own business priorities," the panel concluded. WJ

Related Court Document:
Opinion: 2013 WL 500373

CDO complaint against Credit Agricole filed too late

Credit Agricole has been successful in its bid to dismiss a lawsuit filed in federal court alleging the company and hedge fund Magnetar profited at the expense of investors by creating a collateralized debt obligation designed to fail.

Intesa Sanpaolo S.p.A. v. Credit Agricole Corporate & Investment Bank et al., No. 12- cv-2683, 2013 WL 525000 (S.D.N.Y. Feb. 13, 2013).

U.S. District Judge Robert W. Sweet of the Southern District of New York dismissed the suit, saying it was filed "exactly one month" after the five-year limitations period expired.

Plaintiff Intesa Sanpaolo S.p.A. claimed that French investment bank Calyon, a subsidiary of Credit Agricole currently operating under the name Credit Agricole Corporate and Investment Bank, created a CDO to be insured by Intesa and sold to investors while knowing the underlying assets would underperform and result in significant losses to the investors and Intesa.

A CDO is a security backed by pools of other debt securities, sometimes mortgage-backed securities, credit derivatives or other structured-debt securities.

Calyon worked with hedge fund Magnetar to create Pyxis ABSD CDO 2006-1, a CDO backed by risky mortgage-backed securities, the complaint said.

A mortgage-backed security is backed by pools of mortgage loans whose principal and interest payments are distributed to investors with varying maturity dates, cash flows and default risks.

According to the complaint, Magnetar's investment strategy allegedly involved approaching investment banks to create CDOs. Magnetar would agree to invest in the lowest-quality securities of the CDO and pay above-market fees to the investment bank, the suit said.

In exchange, Intesa claimed, the investment bank would allow Magnetar to secretly choose the underlying assets of the CDO.

The investment bank, meanwhile, would allegedly represent to investors that the underlying assets of the CDO were chosen by an independent collateral manager acting in the best interests of the investors, the complaint said.

REUTERS/Jean-Paul Pelissier

The suit claimed that French investment bank Calyon, a subsidiary of Credit Agricole, created a CDO knowing the underlying assets would underperform and result in significant losses to investors.

Magnetar would then fill the CDOs with toxic assets that would default shortly after being issued, Intesa claimed.

At the same time, Magnetar would allegedly begin shorting the CDO by purchasing significant credit-default-swap positions against the CDO, the suit said.

"Shorting" refers to an investment strategy consisting of a bet that a security will fall in value. A credit-default swap is a kind of financial insurance lenders use to hedge against default risk.

As a result, the suit said, the CDO would begin underperforming upon hitting the market, and Magnetar would make a substantial profit through its large short position over its small investment loss.

In this case, Magnetar created and shorted the Pyxis CDO with Calyon acting as the investment bank, the suit says.

According to the complaint, Intesa, unaware that Magnetar had allegedly created the Pyxis CDO with Calyon, entered into a $180 million credit-default-swap transaction with Calyon whereby Intesa agreed to provide insurance to Calyon on top-level Pyxis CDO notes.

The Fitch ratings agency downgraded the notes April 30, 2008, two years after their issuance, resulting in a "credit event" that forced Intesa to buy the now-worthless notes for $180 million, the suit said.

Intesa filed its complaint April 26, 2012.

Credit Agricole filed a motion to dismiss, arguing that the complaint was not filed within the applicable limitations period.

According to Judge Sweet's opinion, a complaint asserting federal securities law violations must be filed no later than the earlier of two years after the violation is discovered or five years after the violation occurs.

Fitch downgraded the notes two years after their issuance, resulting in a "credit event" that forced the plaintiff to buy the now-worthless notes for $180 million, the suit said.

The opinion says discovery of the defendants' violations could not have occurred until July 21, 2011, when emails detailing the alleged scheme were made public, making the two-year deadline July 21, 2013.

The violations, however, last occurred March 6, 2007, when the last alleged misrepresentation occurred, thereby imposing a March 6, 2012, deadline, according to the opinion.

Judge Sweet ruled that the earlier March 6, 2012, deadline applied, thus making Intesa's April 6, 2012, filing "exactly one month too late." WJ

Related Court Documents:
Opinion: 2013 WL 525000
Complaint: 2012 WL 1141616

Southwest failed to redact credit card info on receipts, class action says

A Southwest Airlines passenger has filed a class-action lawsuit accusing the carrier of failing to redact ticket purchasers' credit card information on some of its sales receipts.

Lumos v. Southwest Airlines Co. et al., No. 3:13-cv-00342-JLS-BGS, complaint filed (S.D. Cal. Feb. 12, 2013).

Jamie Lumos' federal suit, filed in the U.S. District Court for the Southern District of California, says Southwest violates the Fair and Accurate Credit Transactions Act, 15 U.S.C. § 1681c(g)(1), by leaving unredacted credit card expiration dates on the receipts the airline issues at airport ticket counters.

Southwest agents at San Diego International Airport issued Lumos a ticket receipt May 3, 2012, that included all four digits of her credit card expiration date, the complaint says.

"Southwest systematically and routinely violated" the Fair and Accurate Credit Transactions Act, the complaint says.

FACTA requires merchants printing electronic sales receipts to redact all but the last five digits of a customer's 16-digit credit card number and to black out the card's entire expiration date. The law provides for damages of $100 to $1,000 per violation against any defendant who "willfully" fails to comply with its redaction requirements.

"Southwest systematically and routinely violated this law," the complaint says.

Congress enacted FACTA in 2003 to combat identity theft, and a phase-in of the law's various provisions began in 2005, according to the complaint. But confusion over whether the law required merchants to redact expiration dates or only credit card numbers led Congress to pass the Credit and Debit Card Receipt Clarification Act in 2008.

REUTERS/Frank Polich

The suit says Southwest Airlines violates the Fair and Accurate Credit Transactions Act by leaving unredacted credit card expiration dates on the receipts the airline issues at airport ticket counters.

The Clarification Act, which amended 15 U.S.C. § 1681n, reiterated that printing a credit card expiration date is a FACTA violation, but it also gave merchants a "one-time safe harbor" for earlier violations involving expiration dates, according to the complaint. The new compliance deadline became June 3, 2008.

"Importantly, the Clarification Act did not excuse violations on a going-forward basis," the suit says. "The printing of a payment card's expiration date after June 3, 2008, is a violation."

Lumos argues that Southwest's failure to redact expiration dates must be a "willful" violation giving rise to FACTA liability because all the airline's online sales comply with FACTA. Only Southwest's in-person ticket sales violate the law's redaction requirements, the suit says.

The airline also does business with card issuers, such as Visa, whose "card acceptance guidelines" expressly state FACTA's requirements, as do the Federal Trade Commission's published guidelines, according to the complaint.

In seeking class certification, Lumos says the suit satisfies the basic class-action requirements of numerosity, commonality, typicality and adequacy of representation. She also argues that a class action would be the best method of resolving the FACTA claims against Southwest.

"The damages or other financial detriment suffered by individual class members is relatively small compared to the burden and expense that would be entailed by individual litigation," the complaint says. "It would thus be virtually impossible for the class, on an individual basis, to obtain effective redress." WJ

Attorney:
Plaintiff: Todd D. Carpenter, Carpenter Law Group, San Diego

Related Court Document:
Complaint: 2013 WL 507907

Execs' risky business loans led to La Jolla Bank failure, FDIC says

The top officers of La Jolla Bank negligently approved risky real estate and development loans that led to its failure in 2010, the Federal Deposit Insurance Corp. has charged in a San Diego federal court suit.

Federal Deposit Insurance Corp. v. Colbourne et al., No. 13-0351, complaint filed (S.D. Cal. Feb. 13, 2013).

A complaint filed by the FDIC in the U.S. District Court for the Southern District of California seeks unspecified compensatory damages from former Chairman Richard K. Colbourne, ex-CEO Rick F. Hall and former vice president Martin Rodriguez.

The suit accuses them of gross negligence and breach of fiduciary duty for allegedly ignoring sound lending practices in highly speculative commercial real estate loans and acquisition, development and construction loans that allegedly caused the bank's failure.

The defendant officers pushed bank employees to accept an unhealthy amount of these CRE and ADC loans even after receiving warnings from banking regulators that the national boom in such high-risk loans was a "bubble" that "will end badly," according to the complaint.

The expansion of the bank's business due to those speculative loans produced a $1.6 million bonus for Hall in 2004, a $1 million salary increase by 2008, and more authority to approve even bigger loans, the suit says.

He used that authority to form a "Friends of the Bank" group of business people who appeared to get favored treatment — including even looser underwriting standards — when applying for loans, the FDIC says.

As a result of those practices, the bank went further out on a financial limb, the agency says. Its 2008 financial statements misstated net income by $22 million, and a 2009 independent auditor's report concluded that loan loss reserves were underfunded by at least $180 million, according to the complaint.

After federal regulators closed the bank in February 2010 the FDIC, acting as the receiver, investigated the three officers' loan practices and concluded that they had failed to implement sound loan underwriting and credit administration policies.

The suit charges all three defendants with negligence and breach of duty and seeks unspecified compensatory damages plus interest. WJ

Attorneys:
Plaintiff: Anthony J. Dain, Frederick K. Taylor and Heather A. Cameron, Procopio, Cory, Hargreaves & Savitch, San Diego

Related Court Document:
Complaint: 2013 WL 529682

Debt relief

CONTINUED FROM PAGE 1

which was later acquired by nonparty Bank of America. In December 2010, however, they were having difficulty meeting mortgage payments and contacted a bankruptcy attorney, who referred them to Legal Helpers Debt Resolution, the suit says.

The Friels says they entered into a retainer agreement with Legal Helpers, based on their belief that thousands of people in their same position had entered similar agreements to obtain residential home loan modifications.

The suit says the retainer agreement failed to disclose that none of the defendants are licensed to practice law in Washington. In addition, the defendants have not been licensed to provide mortgage loan modifications by the Washington State Department of Financial Institutions, as required by state law, according to the suit.

After paying a $1,400 "processing flat fee" and a $1,423 "mitigation flat fee," the Friels say, they followed directions to stop making mortgage payments and to direct all communications with the bank to the defendants.

Over the next 15 months, the Friels exchanged emails and telephone calls with numerous people who indicated they were agents of the company defendants, the suit says. None of them was an attorney, however, and by September 2012, the Friels were unable to reach anyone at the phone numbers or email addresses they had been provided, according to the complaint.

The suit says the couple instead worked out a loan modification with Bank of America. No one at any of the defendant companies helped them in altering their mortgage, the suit says.

The Friels are suing for violations of the Washington Consumer Protection Act, Wash. Rev. Code § 19.146, and also raise causes of action for breach of fiduciary duty and unjust enrichment. The plaintiffs are seeking class certification for similarly situated Washington residents and an injunction to prevent the defendants from continuing to offer loan modifications in the state.

> The plaintiffs allege that Legal Helpers Debt Resolution LLC took a retainer payment in exchange for helping them with their mortgage, but never followed through.

The complaint also seeks an award of unspecified damages, attorney fees and costs. WJ

Attorney:
Plaintiff: Toby J. Marshall, Terrell Marshall Daudt & Willie, Seattle

Related Court Document:
Complaint: 2013 WL 664509

See Document Section A (P. 15) for the complaint.

Investors not blindsided by AIG's $10 billion subprime suit, BofA says

American International Group's $10 billion lawsuit over subprime-mortgage-backed securities it bought from Bank of America was not the cause of the bank's 2011 stock price drop, BofA has told a federal judge in Manhattan in support of its bid to dismiss a securities fraud suit.

REUTERS/Brendan McDermid

REUTERS/Chris Keane

The AIG suit alleges BofA executives violated federal securities laws by hiding "the largest individual investor claim of its kind against any financial institution in the U.S."

In re Bank of America AIG Disclosure Securities Litigation, No. 11-6678, reply brief filed (S.D.N.Y. Feb. 19, 2013).

In a reply brief filed in the U.S. District Court for the Southern District of New York, BofA and its officers and directors say they did not hide the pending suit from the investment community and that the stock price dropped for other reasons.

BofA wants U.S. District Judge Samuel Conti to dismiss the securities fraud charges against it.

The plaintiffs' consolidated suit says top BofA executives deceived investors, propped up the troubled bank's stock price with misrepresentations and violated federal securities laws by hiding "the largest individual investor claim of its kind against any financial institution in the U.S."

In 2011 BofA's financial reports revealed a barrage of shareholder and regulatory actions related to the collapse of high-risk mortgage-backed securities and the financial industry meltdown from 2008 to 2010, the plaintiffs' suit said.

Those disclosures included suits against BofA and the two financial institutions that it rescued as part of the federal government's bank bailout, Countrywide Financial Corp. and Merrill Lynch & Co., the plaintiffs said in opposition to BofA's motion to dismiss their suit.

LOOMING SUIT

But BofA's financial reports for the first three quarters of 2011 intentionally left out "this looming lawsuit" by insurance giant AIG which "shocked investors, pounding BofA's shares when the truth was finally revealed," according to the plaintiffs' briefing.

The revelation in August 2011 that AIG had filed a $10 billion, 187-page complaint against BofA and its rescued banks over $28 billion in subprime mortgages they allegedly sold it "hammered" BofA's share price, which closed down 20.3 percent the next day, the plaintiffs' brief says.

The shareholder plaintiffs allege that BofA executives had known about AIG's pending suit since January 2011 but hid it in order to inflate the company's stock price.

In its reply brief in support of the motion to dismiss, BofA says the defendants "could not have had a duty to disclose that AIG was considering suit or the size of the suit … because both of these facts were part of the mix of publicly available information."

HOW 'IMMINENT'?

Moreover, BofA did not, as plaintiffs allege, have a duty to warn that the AIG suit was "imminent" because even the complaint does not claim the bank knew or could have known about it, according to the brief.

Finally, the plaintiffs' own complaint admits that BofA and AIG had been in talks to settle AIG's claims, so there was no reason to believe the suit was imminent, BofA says.

The bank adds that there was no reason for it to try to hide the potential suit because it would lose money the same as the other shareholders if the stock price tanked. Therefore, there is no evidence of *scienter*, *i.e.*, that the defendants intended to deceive investors, BofA says.

The plaintiffs have also failed to show "causation," *i.e.*, that the news of the suit caused the severe stock drop in August 2011 that hurt investors, BofA says in the reply brief.

"As defendants showed, the decline in … [BofA's] stock price Aug. 8, 2011, coincided with the first trading day after S&P's unprecedented downgrade of the U.S. government [credit rating] — a day on which each and every stock in the S&P 500 declined," BofA says.

Attorneys:
Plaintiffs: Jason Zweig, Hagens Berman Sobol Shapiro LLP, New York

Defendants: Jeffrey Burke, Winston & Strawn, New York

Related Court Document:
Reply in support of motion to dismiss: 2013 WL 705844

CASE AND DOCUMENT INDEX