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WHAT'S INSIDE

TELEPHONE CONSUMER PROTECTION ACT

8 Judge says bank must face lawsuit over debt collection calls

Hofer v. Synchrony Bank (E.D. Mo.)

TRUTH IN LENDING ACT

9 Car dealer inflates prices to get better bank deal terms, suit says

Gregory v. Metro Auto Sales (E.D. Pa.)

CONVERSION

10 High court rules post-petition earnings revert to debtor after conversion

Harris v. Viegelahn (U.S.)

DEBT SECURITIES

11 Delaware Chancery Court judge offers guidance on creditor standing in fiduciary-duty suit

Quadrant Structured Prods. v. Vertin (Del. Ch.)

ERISA

13 Citigroup employees' ERISA suit over 401(k) losses dismissed

In re Citigroup ERISA Litig. (S.D.N.Y.)

MORTGAGE-BACKED SECURITIES

14 Wall Street banks found liable in mortgage-backed securities suit

Fed. Hous. Fin. Agency v. Nomura Holding Am. (S.D.N.Y.)

15 Financial industry groups urge judge to toss FDIC's $388 million MBS suit

FDIC v. Chase Mortgage Fin. Corp. (2d Cir.)

ARBITRATION

Judge: Citibank's 'relationship' with cardholder not grounds for arbitration

In a credit card debt collection dispute, a California federal judge has denied a request by Citibank to compel arbitration premised on an alleged "relationship" the bank developed with the plaintiff through cardholder agreements for two unrelated cards.

CONTINUED ON PAGE 16

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The judge rejected Citibank's assertion that cardholder agreements for two Sears cards the bank issued to the plaintiff should extend to a Macy's store credit card issued by Department Store National Bank — the retailer's financing arm and an alleged Citibank subsidiary.

COMMENTARY

Preserving human judgment in the age of machines

Kimberly Bernatz, senior vice president and director of wealth management advisory services at First American Trust, discusses automated financial management systems and the issues bankers and investors should keep in mind before deciding to use a robo-adviser platform.

SEE PAGE 3

COMMENTARY

Has the Supreme Court twisted arbitration agreements into a de facto liability shield?

Jeffrey Salas of Salas Wang LLC discusses recent U.S. Supreme Court decisions interpreting Section 2 of the Federal Arbitration Act and argues that these rulings ignore the statute's legislative history. He urges Congress to step in to protect consumers' rights.

SEE PAGE 5

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TABLE OF CONTENTS

Arbitration: *Savage v. Citibank*
Judge: Citibank's 'relationship' with cardholder not grounds for arbitration (N.D. Cal.)....1

Commentary: By Kimberly Bernatz, CFP, First American Trust
Preserving human judgment in the age of machines 3

Commentary: By Jeffrey Salas, Esq., Salas Wang LLC
Has the Supreme Court twisted arbitration agreements into a de facto liability shield? 5

Telephone Consumer Protection Act: *Hofer v. Synchrony Bank*
Judge says bank must face lawsuit over debt collection calls (E.D. Mo.)....8

Truth in Lending Act: *Gregory v. Metro Auto Sales*
Car dealer inflates prices to get better bank deal terms, suit says (E.D. Pa.)....9

Conversion: *Harris v. Viegelahn*
High court rules post-petition earnings revert to debtor after conversion (U.S.).... 10

Debt Securities: *Quadrant Structured Prods. v. Vertin*
Delaware Chancery Court judge offers guidance on creditor standing in fiduciary-duty suit (Del. Ch.)....11

ERISA: *In re Citigroup ERISA Litig.*
Citigroup employees' ERISA suit over 401(k) losses dismissed (S.D.N.Y.) 13

Mortgage-Backed Securities: *Fed. Hous. Fin. Agency v. Nomura Holding Am.*
Wall Street banks found liable in mortgage-backed securities suit (S.D.N.Y.)....14

Mortgage-Backed Securities: *FDIC v. Chase Mortgage Fin. Corp.*
Financial industry groups urge judge to toss FDIC's $388 million MBS suit (2d Cir.) 15

News in Brief 17

Case and Document Index....18

Preserving human judgment in the age of machines

By Kimberly Bernatz, CFP,
First American Trust

Each year, the financial services industry seems to become more and more automated. ATMs reduce the need for bank tellers, online stock and bond trading minimize the role of the broker, and now wealth management advisers may be at risk for being replaced by "robo-advisers." Or are they?

Robo-advisers are Internet-based financial management systems that provide automated portfolio oversight. The platforms lessen the need for personal interaction with financial professionals and use algorithms to comb the markets for data and to allocate assets for a client account.

The trend in the growth of robo-advising is both a blessing and a curse. On the one hand, a robo-adviser can be very helpful for bankers who want to recommend an account that they hope will keep pace with the general market trajectory. Robo-advisers may accomplish this over the long term.

The algorithms within the robo-advising programs have become sophisticated enough to allocate and rebalance funds strategically depending on a client's age, risk tolerance and asset allocation. Some of the virtual planning programs can even automate tax-loss harvesting.

But are these driverless vehicles the best products for everyone? My answer is a definitive no. Wealth managers are not obsolete cogs in the machine. They are the men and women who understand the value of knowing their clients — on a human and personal level. By having a deeper understanding of their clients, wealth managers can advise them and guide their savings and investments based on what they have learned through human interaction, not merely by relying on the basic data that's entered into a bank's robo-advising system when an account is opened.

Instead of every account being simply an identification number and an age, it's Hilary, who is putting two kids through college while trying to grow her retirement nest egg, or John, who just sold a condo and is looking to buy a house while funding a special needs trust for his disabled child.

> The trend in the growth of robo-advising is both a blessing and a curse.

These are real people with real-life issues, and they deserve real financial advice — backed by human judgment — that is formulated and then modified based upon changing needs.

ARE ROBOTS RUNNING THE INDUSTRY?

Wealthfront, Betterment and Personal Capital are better-known examples of robo-advising platforms. According to CB Insights, a company that provides financial industry data, robo-advisers raised $290 million in 2014, more than twice the amount raised in 2013 and more than eight times the amount raised in 2012. However, the algorithms upon which these robo-advice platforms are built still have a long way to go if they're going to completely and accurately compute our financial futures.

According to a survey by consulting firm Corporate Insight, the top 11 robo-advising companies have $19 billion in combined assets under management. In comparison, registered investment advisory firms manage nearly $61.7 trillion, according to a 2014 study of U.S. Securities and Exchange Commission data conducted by two industry trade groups. Robo-advising may be a popular topic of discussion in the banking industry, but it is certainly nowhere near threatening the traditional wealth management model, and it is not growing as fast as some in the industry have predicted.

THE ROLE OF VIRTUAL ADVISERS

Robo-advisers can be a valuable tool for people who are just starting to save and those who may not meet the minimum required asset levels of many financial advisory firms. Many of the people who are currently best served by a robo-adviser may opt to transfer their assets to full-service financial advisory firms as their portfolio grows and their lives become more complicated. A college student with $1,000 may be a good fit with a robo-adviser now. But in 10 years, as a marketing executive with a six-figure salary who is married with children, she will likely need a personal financial adviser to manage the intricacies of her financial life.

The robo-advising computer program should be able to automatically modify allocations to stock, bond and cash positions as circumstances dictate — whether it's diversifying away from a particular sector that has grown to encompass too much of the overall portfolio or moving money into lower-risk positions when the client reaches a certain age. The algorithm should be able to meet benchmarks and keep the portfolio diversified.

Additionally, because the process is automated, the management fees are often less than those for actively managed account

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fees ranging from 15 percent to 35 percent depending on the value of the account.

Some compare the automated approach of robo-advisers to the one-size-fits-all style of target-date funds in a 401(k). Target-date funds automatically reset the asset mix of stocks, bonds and cash in a portfolio according to a specific timeframe, typically an event such as retirement. But these funds may not be the best option for a person who needs some customization to his or her financial plan.

> Wealth managers are not obsolete cogs in the machine.

As an example, a woman retiring in 2045 may have a large trust that she will benefit from in a couple of years. This would allow her to take on more risk than a woman who is retiring the same year while lacking an emergency fund and having a low-paying job and ailing parents.

However, as with robo-advisers, target-date funds are a beneficial option for those who do not wish to manage their own investments or hire someone else to do so. The advice and allocation may be cookie-cutter, but that does not mean that some people won't find it helpful.

A Nationwide Retirement Institute study found that 56 percent of millennial investors think that they would be more financially successful with professional financial advice. However, only 39 percent of these investors actually use an adviser. The virtual adviser is a resource to fill this gap between do-it-yourself investing and the advice of an experienced financial adviser.

A large part of a financial adviser's job is to understand clients' goals and risk tolerance, create a plan, and then control the cycle of fear and greed that often threatens to derail such plans. Investors are prone to react based on emotions, and a robo-adviser lacks the ability to reassure the client, talk through the reasoning behind a market pullback, remind the client of the long-term strategy, and help avoid a knee-jerk reaction that would deviate from the plan and put the portfolio at risk.

The adviser part of "financial adviser" does not only apply to developing and implementing the financial analysis and investment strategy. Advisers are there to counsel clients through the psychological ups and downs of both bull and bear markets. Left without human interaction and the elements of trust, reasoning, guidance and compassion that professional advisers can offer, people using robo-advising platforms will have to fend for themselves when it comes to managing their impulses and gut reactions.

THE ROLE OF FINANCIAL ADVISERS

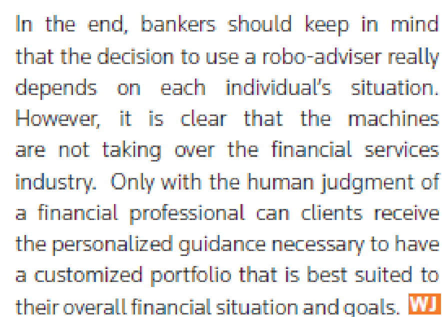
The certified financial planner designation is one of the most well-recognized and respected in the industry. According to the CFP Board, there are eight principal topics on the CFP exam and only one is related to investment planning, which is the primary role of the robo-adviser.

The other topics the CFPs must master include general principals of financial planning, insurance, income tax, retirement and estate planning, professional conduct and fiduciary responsibility, and interpersonal communication. The topics are complex, and the needs of individuals are unique.

A robo-adviser would be hard-pressed to address many other financial needs such as deciding to take a lump-sum distribution from a pension plan or evaluating long-term-care policies.

lifestyle considerations are all aspects that are best addressed by a qualified person, not a computer program. An investor may think he has a high risk tolerance, yet panics and goes to cash when the market takes a dip. Advisers can help assess what strategy a client is comfortable with, and make sure that accounts are adjusted as life circumstances change.

At wealth management firms the need for personal knowledge and customization is critical because the client's needs are more complex. With larger estates and a wider array of assets to manage, it is important to have a comprehensive plan and to ensure that all the investments are positioned appropriately based upon the client's goals, risk-tolerance and timeline. As personal wealth grows, assets typically become more complex and intertwined; therefore, having the benefit of an experienced and talented team to tailor these moving parts will benefit the clients and their beneficiaries.



CONCLUSION

In the end, bankers should keep in mind that the decision to use a robo-adviser really depends on each individual's situation. However, it is clear that the machines are not taking over the financial services industry. Only with the human judgment of a financial professional can clients receive the personalized guidance necessary to have a customized portfolio that is best suited to their overall financial situation and goals. WJ