***Payments Pros – The Payments Law Podcast* — Navigating Elder Fraud: Challenges and Legal Trends in Payment Systems**
Host: Carlin McCrory
Guest: Mary Zinsner
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Carlin McCrory:

Welcome to another episode of *Payments Pros*, a Troutman Pepper Locke Podcast, focusing on the highly regulated and ever-evolving payment processing industry. This podcast features insights from members of our FinTech and payments practice, as well as guest commentary from business leaders and regulatory experts in the payments industry. I'm Carlin McCrory, one of the hosts of the podcast.

Before we jump into today's episode, let me remind you to visit and subscribe to our blog, TroutmanFinancialServices.com. And don't forget to check out our other podcasts on troutman.com/podcasts. We have episodes that focus on trends that drive enforcement activity, digital assets, consumer financial services, and more. Make sure to subscribe to hear the latest episodes.

Today, I'm joined by my colleague, Mary Zinsner to discuss litigation trends in the payments industry. Mary is a partner in our Consumer Financial Services Practice Group, specializing in litigation and strategy across various financial services and consumer -related disputes, including lender liability, class actions, and claims under key financial regulations. Mary, thanks so much for joining me today.

Mary Zinsner:

Thanks, Carlin, and I'm excited to be here.

Carlin McCrory:

So, let's go ahead and dive right in, Mary. Elder fraud and financial exploitation is definitely in the news, and regulators are focusing on training and detection of both of these things, and state legislators are enacting new laws to impose more stringent reporting requirements on financial institutions. So, Mary, I'm interested to hear about what you're seeing in your practice as it relates to this.

Mary Zinsner:

Sure. I'm glad, I'm glad to talk about it. Some of you may be wondering why we're talking about elder fraud on a payments podcast. The reason is, is that the elder fraud cases we see involve payments. They involve wire transfers, electronic fund transfers, cash withdrawals, checks. The whole panoply of the payment system. Ten years ago, elder fraud cases were relatively rare. I, I really didn't have any of my practice, and now, handle several significant cases a year involving

elder financial exploitation for our financial institution clients. There's often big dollars involved, many times the life savings of the elderly, senior bank customer, and so, they're big-ticket litigation matters.

Carlin McCrory:

Can you give some examples of the types of fact patterns that you've been seeing and the different claims that are being asserted against the financial institutions?

Mary Zinsner:

Honestly, these cases are all very, very sad. They often involve love scams or friendships, someone who befriends the vulnerable adult and exploits the relationship. They ask the elderly person to wire funds to an international account for myriad reasons, and then, the money is gone. We also see patterns where an elderly person is duped by either a new online friend or somebody who calls the elderly person on their landline or their cell phone, and they're convinced to give either cash to the fraudster, or use the cash to purchase gift cards, or engage in other transactions. We're seeing a fair number of payment app transfers using Zelle and Venmo, and the elderly person transfers money to the fraudster, and then, the money's gone.

What's happening then is once the family members find out about it, they often turn to the deep pocket, which is the financial institution, and try and seek redress from the bank. They assert myriad claims. We have seen claims that the bank had a duty to detect and prevent the transaction. We see negligence claims, assumption of duty type claims, breach of contract, breach of implied covenant of good faith and fair dealing. We're seeing a lot more UDAP-type claims, just allegations that by the bank allowing the transaction and not deterring it or preventing it. We've engaged in an unfair and deceptive practice.

Then, the latest trend is what I call a compliance predicated claim. The argument by the clever plaintiff's lawyers is that the banks have Bank Secrecy Act, and know your customer obligations, and red flags must have been triggered by this transaction. And we therefore violated duties of care by ignoring these red flags and allowing the transactions.

Carlin McCrory:

That's interesting that you're saying that, Mary, because I could see where there could potentially be some churn between an elderly customer if the bank decides to not allow them to conduct a transaction, right? So, let's say, the bank is saying, "Well, okay, now we're putting all this pressure on ourselves due to the litigation that we think this activity is a red flag, so we're not going to allow you to do it." Then, the customer gets angry. Have you seen any of that at all?

Mary Zinsner:

Yes, we sure have. Honestly, the banks and financial institutions are caught between a rock and a hard place. There's no right answer in these cases, and we have our clients who decline the transactions, and then we have our clients who go ahead with the transaction, try and advise

the customer against it, and then, report the transaction through a SAR or to adult protective services, and then, they still get sued. So, it's just one of those situations where there is no right answer, and you really -- each situation is difficult.

I will say, though that, with respect to our financial institution clients, we are frequently able to escape liability in these cases just because the law is bank-friendly in this area. That's because banks are banks, we're bankers. You're not in the industry of protecting the person or property of an individual. You're there to process the transactions that they authorize, and oftentimes, these are authorized, and there's multiple indicia of the customer's authorization. So, we're really able to defeat a lot of these claims, usually on the motion to dismiss phase of a case, but sometimes, it goes through discovery, and it's at summary judgment.

Then, we can defeat it by really arguing things like the Bank Secrecy Act doesn't confer a private right of action, so they can't use the BSA and know your customer laws to masquerade some common law claim. You can't assert a Bank Secrecy Act claim because there's no private right of action, so you can't come to the back door and do what you can't do in the front door. So, that's really the argument we make. There's some good case law we've also developed on the negligence and there's no duty of care.

People often have a hard time with that. How can you not owe a duty of care to an elderly customer? The reason is, the law of negligence is in place and the duty of care is in place to protect an individual from injury to person or property. So, we have a duty of care, not to leave a ladder out in front of the branch so that somebody trips on it when they walk in. That's the type of duty of care the common law recognizes. It's very rare to have any state law court recognize a duty of care to protect or prevent an elderly customer from authorizing the bank to do a transaction that may turn out to be a scam. That's how we're successful there.

Then, again, on the breach of contract and breach of implied covenant of good faith and fair dealing claims. Those claims, really, we can get rid of on the same basis. Our contract of deposit doesn't impose on us a duty to detect or deter scams. Our duty is to undertake the transactions duly authorized by our customer to do what they're asking us to do with their money.

Carlin McCrory:

Right. Yes, this isn't a black and white situation. These are judgment calls that the bank would need to make, so that makes a whole lot of sense. Still on the topic, what are the state legislatures doing to stay on top of elder fraud?

Mary Zinsner:

Yes, that's a great question, Carlin. It's really something everyone needs to be monitoring pretty closely. States are very active in this area. There is a lot of bipartisan support, understandably, for laws protecting our elderly population. So, what we're seeing is some states enacting more, making financial institutions mandatory reporters of financial exploitation. Then, also seeing some laws really kind of creating trusted contact programs, even for institutions that don't have a trusted contact program, and really immunizing a bank. If they have, and the statutes read something like, if the bank has knowledge to reasonably associate a person with the elderly

person, then, they can communicate and reach out to that person to alert them of the possible fraud without being criminalized or have any liability for exposing that customer's personal financial information.

Honestly, the laws are good. We all have a duty to protect our elderly population, and it's really just a matter of recognizing it, and knowing what the law is in your particular state.

Carlin McCrory:

That's great. So now, let's turn a little bit to wire fraud. So, I mean, across the board, we're seeing an increase in wire fraud. We see it in, for example, commercial closings. The news is also full of misdirected wire transfers and residential home closings, home renovations, title insurance companies, and the closing attorneys are on the hook. Can you address why you think we're seeing a rise in these wire fraud cases and how the financial institutions are implicated with these?

Mary Zinsner:

It's actually kind of stunning to me that we're still seeing so many of these wire fraud cases given the publicity that's out there about business email compromise and what

the risks there are in every real estate closing, and just the need to verify, verify, verify in person, and not rely on the email communications, et cetera. But there are an extensive amount of wire fraud cases out there. It's also surprising to me that the banks are still being sued in these cases, and again, it's largely because the plaintiff lawyers and the families involved in the losses see the banks as the deep pocket and think they can get easy redress. But the Uniform Commercial Code is what governs the whole liability scheme between the parties to a wire transaction. The UCC is drafted to really put the loss on the party closest to the fraud, which is usually the customer or the party duped. It's not typically the bank.

We are seeing a lot of good case law, particularly coming out of our federal circuit courts. There was a really great case recently out of the Fourth Circuit, where the Fourth Circuit reversed a troubling decision out of the Eastern District of Virginia. It's a really good read, but it essentially protects the bank, and says that the lower court had held that the bank knew that there was a mismatch between the beneficiary name of the wire and the account number because its system had alerted it to the mismatch. But the Fourth Circuit went out of its way to say, "That type of electronic knowledge of the bank system is not enough to comprise the actual knowledge required under the UCC. The UCC uses that terminology, actual knowledge for a reason. There was no one person at the bank with actual knowledge of that mismatch. So, the Fourth Circuit reversed and ruled in favor of the credit union in that case. So, again, it's a good read.

The other area that we're seeing just a ton of litigation is EFTA, Electronic Funds Transfer Act cases. Candidly, we've just seen a significant escalation of EFTA claims in the past 12 to 18 months. They're often very small dollar claims. So, they're problematic, because it's going to take, cost you more to litigate the case than to settle it. But we really encourage our clients to defend the cases if you have good facts. Good facts include the customer being the one who took the actions or steps to make the funds transfer rather than the fraudster.

I mean, EFTA is drafted in a very broad remedial way to put the loss on the banks, but it's only if somebody other than the customer initiated the transaction. If the customer themselves initiated the transaction, even though they were induced by fraud, it's still considered under the law an authorized transaction, and there should not be a recovery under EFTA. So, we really encourage our clients to draw a hard line and to defend the good cases to help develop a good body of law along this same line.

Carlin McCrory:

Check fraud is actually increasing and increasing may be an understatement, skyrocketed. I know there are so many alerts about this. I think, FinCEN has put out a couple alerts on this now. It's a little bit surprising in this era of electronic payments. I think, I don't know, I've personally experienced a check that was getting stolen out of the mail. So, can you talk a little bit, Mary, about why there's been this rise in check fraud and the type of claims that you're seeing?

Mary Zinsner:

Sure. Everyone is surprised when they hear the check fraud is on the rise and they read the headlines, because checks are not in vogue anymore. Everyone uses Venmo, and Zelle, and PayPal, and there's a whole generation who probably haven't even seen checks. Nobody writes checks anymore. But there are a lot of checks moving about in our economy. Older adults still use checks. Companies still write checks. There are tax refund checks in the mail. The reason why we're seeing the uptick in check fraud is just because of opportunity. It's a very low-cost, low-tech, easy method of theft.

You have checks stolen from the mail, and then, altered. You have payment checks that a company receives, and they're altered. You have the whole issue of crooked bookkeepers or stolen check stack, where somebody, a trusted employee, writes, forges checks, or wrongfully endorses checks, and deposits them into his or her own account. We have this whole issue of wash checks now as well. A wash check is a check where a bad actor takes a check and uses chemicals to essentially wash the check and recreate it to have a new payee, a new check amount, et cetera. It looks like a real check. So, it's very troubling.

Then, the issue in those wash check cases is, is this a counterfeit check, or is it an altered check? It's an important distinction because the UCC – the liability scheme is different for an altered check versus a counterfeit check. The responsibility for an altered check usually falls on the bank of first deposit, whereas, a counterfeit check, the liability falls on the issuer. So, it's an important distinction to stay on top of that case law.

Then, the other big trend we're seeing in the area of check fraud is the latest trend is double-presentment cases, where a check is deposited first remotely, and then, represented a second time to a second bank either through an ATM or a teller line. There's no indicia on the check that it was previously deposited. So, the second bank that takes it claims it's still entitled to the funds because it's a holder and due course. There's no indicia that it was remotely deposited the first time. So, it's really important for any financial institution that offers remote deposit to its customer, you need to train your customers on how to write a restrictive endorsement on a check. Many of our teenagers and young adults just do not know how to write a restrictive

endorsement, and they need to be writing as part of that restrictive endorsement that it was deposited by remote means. That simple language warns the ability of the second bank to ever claim that it was a holder in due course of the instrument because it's on notice based on the restrictive endorsement.

Carlin McCrory:

Mary, are you seeing some of these issues as it is between banks indemnifying one another and pushing back on that? Because, I'm assuming if the dollar amount is so low, they're kind of taking the risk of not indemnifying another bank perhaps?

Mary Zinsner:

Yes. It's supposed to happen like clockwork. You get a breach of presentment warranty claim or a challenge from a bank, and it's part of the system of banking that either the bank of first deposit needs to accept responsibility. But because of the issues with the double presentment, there's a little more of a tension, and the double presentment cases often do get litigated. It's not as regular for one bank just to step up to the plate. So, we are seeing more bank-to-bank litigation in the double presentment area.

Carlin McCrory:

Now, I want to talk a little bit about arbitration. So, arbitration, I know, is frequently seen by our businesses and our clients as a more economic and it's an efficient means of resolving some of these consumer disputes. Many of our financial institution clients have incorporated arbitration agreements in their deposit agreements, credit card holder agreements, et cetera. What are some of the advantages of bringing a claim in arbitration versus bringing it in court?

Mary Zinsner:

First of all, let me just have a disclosure that I'm a huge proponent of arbitration. I'm an arbitrator myself. I'm on the AAA roster of neutrals, so decide regularly, consumer and commercial arbitration matters as an arbitrator. Also, as a practitioner, I'm involved in a lot of arbitrations. There's just so many economies to arbitration. The discovery is limited. The cases can be decided on the papers in certain circumstances. They are largely confidential. There's no public docket that the public can pour over. Honestly, the caliber of the arbitrators and the sophistication of the arbitrators is increasing as the arbitration numbers are growing larger. The arbitral forms know that they need to have skilled arbitrators, deciding these issues rather than some of the more typical consumer lawyers who used to preside over these arbitrations in the early stages of arbitrations. Those are all very positive trends in arbitration.

The other thing I just want everyone to understand is you need to follow the developments in the law of arbitration. There are a lot of arbitration decisions being issued by federal district courts and federal circuit courts. And some of them are all over the map. Many relate to changes in terms and whether the customer really had notice and knowledge of the change in terms and an opportunity to ascent to that change in terms. I strongly encourage anyone considering a motion to compel arbitration to go back and look carefully at any roadblocks you might encounter in

fighting or in trying to enforce your arbitration provision just because there are some risks if you lose the matter in a very public opinion. So, it's important to stay on top of the case law and make sure you are dotting your I's and crossing your T's when you are doing a change in terms.

Carlin McCrory:

There's also been a lot of buzz on mass arbitrations. What are you seeing there with mass arbitrations, Mary, and what are the best practices as it relates to these?

Mary Zinsner:

Sure. Well, let me just say, mass arbitration is such a huge topic and such a hot topic right now. We could spend a whole hour talking about mass arbitration alone. But I think, the important thing to take away from this call is really just to understand that any financial institution, any FinTech, any payment processor with an arbitration agreement with a consumer is subject to the risks of mass arbitration. So, you need to stay on top of the case law.

Again, mass arbitrations are really low-dollar, simple issue cases that become exceedingly complex because of the number of cases filed together by the same law firm, seeking really to extort a settlement because of the obligation frequently in the arbitration agreement. Whereas, the financial institution is to pay the filing fees of the arbitration, and those can get very hefty when you have several thousands of cases, and you have to pay $1,500 each for filing fees.

The arbitral forums for a large part, the JAMS and the AAAs and other forums, really have pivoted with some helpful changes to their procedures and rules. They've

modified their filing fee structures. But either way, they are still very expensive, very daunting litigation matters to handle. So, it's important to stay on top of this law as well. Again, mass arbitration and arbitration, we could do a full program on it. But hopefully, what we've instilled here is just the need to stay on top of those, read the case law. When you get a blurb about a new arbitration agreement, or mass arbitration ruling, or a new decision involving a contested motion to compel arbitration, read it just to glean the lessons learned from that opinion and stay on top of the developments.

Carlin McCrory:

Or reach out to you, right, Mary?

Mary Zinsner:

Right. That's right.

Carlin McCrory:

Well, thank you so much, Mary, for joining us today and thanks to our audience for listening to today's episode. Don't forget to visit our blog, TroutmanFinancialServices.com, and subscribe so you can get the latest updates. Please also make sure to subscribe to this podcast via Apple

Podcast, Google Play, Stitcher, or whatever platform you use. We're looking forward to next time.

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