910 Consumer Finance & Banking Year in Review

Scott A. Almy
General Counsel & Secretary
Guaranty Bank

Donald Brewster
SVP & General Counsel
Origen Financial, Inc.

Heather B. Thayer
Senior Counsel
World Savings

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Faculty Biographies

Scott A. Almy
General Counsel & Secretary
Guaranty Bank

Donald Brewster

Donald P. Brewster joined Origen a couple of years ago and currently serves as senior vice president and general counsel. Mr. Brewster came to Origen from KB Home Mortgage in Los Angeles, where he served as senior vice president and general counsel. Mr. Brewster has worked in the housing finance industry exclusively over the past fifteen years in the legal departments of KB Home Mortgage, Freddie Mac, Conseco Finance, GMAC/RFC and Countrywide Home Loans, where he concentrated on the regulatory aspects of consumer financial services and state and federal legislative and administrative agency relations. In addition to his consumer finance regulatory practice, Mr. Brewster's experience includes several years of private practice in Los Angeles in the fields of mortgage revenue bonds, bankruptcy, and securities.

Mr. Brewster is a member of ACC, and the ABA's consumer financial services committee, and the committee on cyberspace. Mr. Brewster is a frequent lecturer to state and national trade groups and professional associations on various consumer finance industry and electronic commerce topics, and served as Adjunct Professor of Law at the University of Minnesota Law School where he taught advanced coursework on consumer finance and electronic commerce topics.

Mr. Brewster is a graduate of Stanford University and the University of Minnesota Law School.

Heather B. Thayer

Heather B. Thayer is the senior counsel for originations and regulatory affairs for World Savings Bank, FSB in Oakland, California. Ms. Thayer is responsible for, among other things, state and federal consumer lending regulatory issues, lending documentation and policies, regulatory analysis and strategy, new products, loan marketing and secondary marketing. Prior to joining World, Ms. Thayer was in private practice for many years in Minneapolis concentrating on consumer and commercial lending issues and commercial bankruptcies.

Ms. Thayer is currently the vice-chair of the access to services subcommittee of the consumer financial services committee of the ABA, and she actively participates in the consumer finance, commercial finance and cyberspace law committees of the ABA. Ms. Thayer also serves on the legal affairs and mortgage-lending committees of the California Banker's Association. She is a frequent lecturer on consumer lending transactions.

Ms. Thayer received her undergraduate degree from Bennington College and her J.D. magna cum laude from William Mitchell College of Law where she was the Warren Burger Entrance Scholar and a member of the Law Review.

CONSUMER LAW LEGISLATIVE UPDATE
2006 AMERICAN CORPORATE COUNSEL ASSOCIATION
HEATHER THAYER
WORLD SAVINGS, FSB

DO NOT FAX

Background

In 2003, the Federal Communications Commission (FCC) issued facsimile (fax) advertising rules of the Telephone Consumer Protection Act of 1991 (TCPA). Under these rules, the "established business relationship" (EBR) exemption would have expired. This exception allowed faxes to be send to persons with whom the sender had an established business relationship. Without it, senders would have had to obtain express permission from each person to whom they send faxes, specifically identifying each fax number, even if faxes were a routine part of the business operations (rate sheets for mortgage lending, for example).

The FCC very quickly issued an order extending the EBR exemption to January 1, 2005, then further extended the exemption to June 30, 2005, then January 9, 2006. In the meantime, in the summer of 2005, the President signed S. 714, the Junk Fax Prevention Act, which restored the EBR exemption and rendered that portion of the fax advertising rules moot. The Junk Fax Prevention Act required the FCC to promulgate implementing regulations for the EBR.

In April 2006, the FCC implemented changes to the fax advertising rules which: (1) codify an EBR exemption to the prohibition on sending unsolicited fax advertisements; (2) define EBR as used in the context of unsolicited fax advertisements; (3) require the sender of fax advertisements to provide specified notice and contact information on the fax that allows recipients to "opt-out" of any future transmissions from the sender; and (4) specify the circumstances under which a request to "opt-out" complies with the Act. The new rules are scheduled to take effect on August 1, 2006.

- An "unsolicited advertisement" is defined as "any material advertising the commercial availability or quality of any property, goods, or services which is transmitted to any person without that person's prior express invitation or permission, in writing or otherwise."

- An "established business relationship" (EBR) means a prior or existing relationship formed by a voluntary two-way communication between a person or entity and a business or residential subscriber with or without an exchange of consideration (payment), on the basis of an inquiry, application, purchase or transaction by the business or residential subscriber regarding products or services offered by such person or entity, which relationship has not been previously terminated by either party.

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Amended Fax Rules and Established Business Relationship Exemption

The rules provide that it is unlawful to send unsolicited advertisements to any fax machine, including those at both businesses and residences, without the recipient's prior express invitation or permission. However, under the amended rules, fax advertisements may be sent to recipients with whom the sender has an EBR, as long as the fax number was provided voluntarily by the recipient. Specifically, a fax advertisement may be sent to an EBR customer if the sender also:

- Obtains the fax number directly from the recipient, through, for example, an application, contact information form, or membership renewal form; or
- Obtains the fax number from the recipient's *own* directory, advertisement, or site on the Internet, unless the recipient has noted on such materials that it does not accept unsolicited advertisements at the fax number in question; or
- For directories and other sources of information compiled by third parties, the sender must take reasonable steps to verify that the recipient consented to have the number listed.
- If the EBR existed before July 9, 2005, and the sender also possessed the fax number before July 9, 2005, the sender may send the fax advertisements without demonstrating how the number was obtained.

Fax advertisements sent with the recipient's prior express permission must include an opt-out notice as described below.

Opt-out Notice Requirements

The rules require senders of permissible fax advertisements (those sent under an EBR or with the recipient's prior express permission) to provide specified notice and contact information on the fax that allow recipients to "opt-out" of future faxes from the sender. The notice must:

- Be clear and conspicuous and on the first page of the advertisement;
- State that the recipient may make a request to the sender not to send any future faxes and that failure to comply with the request within 30 days is unlawful; and
- Include a telephone number, fax number, and cost-free mechanism (including a tollfree telephone number, local number for local recipients, toll-free fax number, Web site address, or e-mail address) to opt-out of faxes. These numbers and cost-free mechanism must permit consumers to make opt-out requests 24 hours a day, 7 days a week.

Senders that receive a request not to send further faxes that meets the requirements listed in the next section must honor that request within the shortest reasonable time from the date of such request, not to exceed 30 days. They are also prohibited from sending future fax advertisements to the consumer unless the consumer subsequently provides prior express permission to the sender.

Opt-out Requests By Consumers

To stop unwanted fax advertisements, consumers' "opt-out" requests must:

- Identify the fax number or numbers to which the request relates; and
- Be sent to the telephone number, fax number, Web site address or e-mail address identified on the fax advertisement.

The consumer can subsequently grant express permission to receive faxes from a particular sender, in writing or orally.

But What About California?

California has its own do-not-fax law, Cal. Bus. & Prof. Code § 17538.43. Like the original FCC rule, California has eliminated the EBR exemption and requires specific express permission prior to all unsolicited faxes. In early February, 2006, the United States District Court for the Eastern District of California considered whether the Junk Fax Prevention Act preempted the California rule, or whether the California rule prevails. *Chamber of Commerce v. Lockyer*, 2006 WL 462482 (E.D. Cal. 2006. The court determined that the State of California has jurisdiction over *intrastate* commerce, while the federal government has jurisdiction over *interstate* commerce. *Id.* at *8. Thus, for faxes sent within the state of California, the California rule prevails and the sender must obtain express permission before sending an unsolicited fax. For faxes originating in California and going out of the state or coming in to California from another state, the federal rule prevails and there is an EBR exemption, so long as the disclosure and opt-out notice rules are followed.

Bottom Line

For faxes sent within the state of California, the California rule prevails and the sender must obtain express permission before sending an unsolicited fax.

For faxes originating in California and going out of the state or coming in to California from another state, the federal rule prevails and there is an EBR exemption, so long as the disclosure and opt-out notice rules are followed.

TELECOMMUNICATIONS

In another California twist, the California Supreme Court ruled in July that California's two-party consent rules apply to all calls with California residents. In many states, such as Georgia, telephone calls may be recorded if just one party consents to the recording. In California, both parties to the call must consent to the recording. In *Kearney v. Salomon Smith Barney, Inc.*, 2006 WL 1913155 (Cal. 2006), Salomon Smith Barney, a brokerage located in Atlanta, both made calls into and received calls from, California. As is common for brokerage houses, all calls were recorded. The California Supreme Court examined the choice of laws issue between Georgia and California at length and determined that California's interest in protecting its citizens' privacy is more important than Georgia's interest. *Id.* at *21.

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The saving grace in *Kearney* is that the court made it clear that explicit permission is not required to comply with California law. So long as California residents are informed in advance that calls may be recorded, they no longer have an expectation of privacy, and the call may be recorded. Therefore, if a business in any state routinely records or monitors calls, and that business may call into or receive calls from California, it is crucial to have an announcement that calls may be recorded in order to comply with California law.

MISCELLANEOUS REGULATORY CHANGES

Domestic Partnership Laws

District of Columbia: Ordinance 9-162. Effective April 3, 2006

Grants domestic partners all of the same rights as spouses.

Of particular interest to creditors, DC Code § 15-502 was amended and now reads:

"A mortgage, deed of trust, assignment for the benefit of creditors, or bill of sale upon exempted articles is not binding or valid unless it is signed by the spouse or domestic partner of a debtor who is married and living with his or her spouse or domestic partner."

Colorado: H 1344. Effective 2/12/2007 upon ballot approval

Grants domestic partners all of the same rights as spouses.

Illinois 4050 Predatory Lending Database

This is an extreme instance of legislation run amok. As of this writing, the law is scheduled to go into effect in eleven business days and the Illinois Department of Financial Institutions has not yet determined how the law will work. Under the law, each residential mortgage loan in certain zip codes in Cook County must go through a two-step process.

Step One

In certain zip codes in Cook County, for all applications taken by Illinois-licensed mortgage bankers and brokers, the brokers will be required to submit to a “predatory lending database” reams of information about the borrower, the loan, the service providers, the fees and the property.

After receiving the information, the Department of Financial Institutions will decide whether or not credit counseling is recommended to the borrower based on published criteria. A loan may not proceed until the Department issues a determination not to recommend credit counseling for the borrower OR if the Department issues a determination that credit counseling is recommended for the borrower, counseling is completed and the credit counselor submits all required information to the database. Therefore, a long waiting period will be added to every loan brokered by an Illinois licensee.

Step Two

Upon the closing of each loan in the affected zip codes, the title company or closer must re-report information to the predatory lending database and obtain a certificate of compliance or a certificate of exemption from the Department. If the title company fails to attach a certificate to the mortgage then the mortgage is not recordable.

The process will be wholly automated, but the Department has not yet finished work on the database. Moreover, for lenders or brokers who are exempt from the law, there is no procedure in place for the title companies to obtain a certificate to be able to record the mortgage. By the time of the ACCA Meeting, we will be able to pick through the pieces of the wreckage to determine what happened.

New York Payment Option Fee Prohibition

No creditor may charge an additional fee for when the payment option chosen by the customer requires use of mail, paper billing or an electronic transaction using the internet or telephone.

Reg E Changes

These changes go into effect on January 1, 2007.

Electronic Check Conversions

This rule primarily governs “ECK transactions” (electronic check conversions) in which information is taken from a check and turned into an electronic debit. Under these transactions, the consumer supplies the merchant (or lender) a check and the merchant turns it into an EFT to debit the consumer’s account. This is NOT the same as check truncation covered by Check 21, in which checks are presented electronically, but instead only covers EFT debits through the ACH system.

Check-by-phone transactions, where information from a check is taken over the phone and a transfer from the consumer’s account is initiated are electronic funds transfers, but are not “ECK transactions” subject to the new ECK disclosures.

Certain of the rules apply to POS (Point of Sale) disclosures. POS transactions are one-time transactions in which a consumer gives a check to a merchant to purchase a good or service and the merchant immediately converts the check to an electronic payment, usually returning the check to the consumer. Merchants must now obtain the consumer's authorization prior to the transaction. There must be a prominent and conspicuous notice posted at the point of sale and a written copy of the notice must be provided at the time of the transaction, such as on the receipt.

Other rules apply to ARC transactions, in which a payee receives a check in payment and processes it as an ECK. In that instance, the billing statement must clearly disclose

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that the payment may be processed as an electronic fund transfer and certain consequences of that processing. Also, if a returned check is processed as an ECK and an NSF fee collected, there must be a disclosure regarding collection of that fee. The following model forms have been provided:

> When you provide a check as payment, you authorize us either to use information from your check to make a one-time electronic fund transfer from your account or to process the payment as a check transaction.
>
> You authorize us to collect a fee of $___ through an electronic fund transfer from your account if your payment is returned unpaid.
>
> When we use information from your check to make an electronic fund transfer, funds may be withdrawn from your account as soon as the same day we receive your payment, and you will not receive your check back from your financial institution.

Authorizing Transfers from Deposit Account

In a separate change, Reg E has now been revised so that repeated ACH transfers from a consumer's account, which have to be authorized in writing, can be authorized through a recorded telephone conversation, if otherwise allowed by applicable law. It is not clear whether the NACHA rules would allow a recording.

Notice of Transfers that Vary in Amount

Currently, before making any transfers that vary in amount from the previous transfers, 10 days' prior written notice must be provided. The changes would require notice of the varying amount only if the variation falls outside an acceptable, preset range.

Error Resolution

Currently, when there is a claim that an electronic transfer in error, the recipient of the complaint need only examine the payment instruction to determine is there has been an error. Under the new rules the institution must also examine any other records in its possession to determine if there has been an error.

GLBA Readiness

- Organizational chart
- Contact list for key individuals
- Network Diagram – schematic outlining entire network
- List of IT systems implemented where customer information is stored or processed.
- IT policies, procedures, standards or other documentation related to the following areas:
    - IT steering committee, including minutes
    - Network and systems monitoring
    - Network and system logging.
    - Disaster recovery and business continuity
    - Information risk identification
    - Hardware/software purchasing
    - Physical security
    - Logical security (user ID's, passwords, authentication)
    - Remote access by users, system administrators and/or customers
    - System/data backup and restore
    - Software development
    - Anti-virus implementation
    - Change management
    - Intrusion detection and incident response
    - Training
    - Encryption
- Employee hiring process
- Employee acceptable use policy or employee manual.
    - Documentation outlining employee requirements related to network access, computers, internet, email, etc.
- Employee training material related to IT, security, customer information handling, etc.
- Latest examination reports for state and/or federal regulatory agencies.
- List of vendors that have access to client information.
- Process used for selecting IT vendors or vendors that will have access to customer information.
- Any documents related to IT security or safeguarding customer information.

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STATE SECURITY BREACH NOTICE LAWS

Arkansas, SB 1167, Ark. Code Ann..§ 4-110-101 *et seq.* (effective March 31, 2005)

California, SB 1386 Cal. Civ. Code §§ 1798.29 and 1798.82-84 (effective July 1, 2003)

Connecticut, SB 650, 2005 Conn. Acts 148 § 3 (Reg. Sess.) (effective January 1, 2006)

Delaware, HB 116, Del. Code Ann. tit. 6 § 12B-101 *et seq.* (effective June 28, 2005)

Florida, HB 481, Fl. Stat. Ann. § 817.5681 (effective July 1, 2005)

Georgia, SB 230, Ga. Code Ann. §§ 10-1-910-912 (effective May 5, 2005)

Illinois, HB 1633, 815 ILCS 530 (effective January 1, 2006)

Indiana, SB 503, Ind. Code § 4-1-11 (applies only to government agencies) (effective July 1, 2005, but applies June 30, 2006)

Louisiana, SB 205, La. Rev. Stat. § 51:3071 *et seq* (effective date of January 1, 2006, but can only take effect after implementing rules are promulgated by state attorney general)

Maine, LD 1671, Me. Rev. Stat. Ann. tit. 10 § 1346 *et seq.* (effective January 31, 2006)

Minnesota, HF 2121, Minn. Stat. Ann. § 325E.61 and HF 225, Minn. Stat. Ann. § 13.055 (HF 2121 effective January 1, 2006, HF 225 has no effective date, signed by the Governor on June 3, 2005)

Montana, HB 732, Mont. Code Ann. § 31-14-1701 *et seq.* (effective March 1, 2006)

Nevada, AB 334 and SB 347, Nev. Rev. Stat. 239B (AB 334 effective January 1, 2007 and SB 347 effective January 1, 2006)

New Jersey, A 4001, N.J. Rev. Stat. § 56:8-161 *et seq.* (effective January 1, 2006)

New York, A 4254-A, N.Y. Tech. Law § 208 (agencies), N.Y. Gen. Bus. Law § 899-aa (businesses) (effective December 8, 2005 [120 days after governor signs the bill])

North Carolina, SB 1048, N.C. Gen. Stat. § 75-65 (security breach notice provision is effective December 1, 2005)

North Dakota, SB 2251, N.D. Cent. Code § 51-30-01 *et seq.* (effective June 1, 2005)

Ohio, HB 104, Ohio Rev. Code Ann. § 1347.12 (agencies), Ohio Rev. Code Ann § 1349.19 (businesses) (effective 90 days after signed bill is filed with Ohio Secy. of State)

Rhode Island, H 6191, R.I. Gen. Laws § 11-49.2-7 (effective on March 1, 2006)

Tennessee, HB 2170 and HB 2220, Tenn. Code Ann. § 47-17-21 (not yet codified) (effective July 1, 2005)

Texas, SB 122, Tex. Bus. & Com. Code § 48.103 (effective September 1, 2005)

Washington, SB 6043, Wash. Rev. Code § 42.17 (agencies) Wash. Rev. Code § 19.255 (businesses) (effective July 24, 2005)

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910: Consumer Financial Services and Banking Law Update

Donald Brewster

Heather Thayer

Preemption

- The U.S. Supreme Court will hear one case this term regarding preemption and the financial services industry.
  - Oral arguments are scheduled for November 29, 2006 in *Wachovia Bank, N.A. v. Watters*, a case challenging the OCC's preemption authority over state regulation of operating subsidiaries of national banks. *Wachovia Bank, N.A. v. Watters*, 431 F. 3d 556 (6th Cir. Mich. 2005).
- However, the Supreme Court declined to hear an appeal in another case involving federal preemption of state law.
  - The Ninth Circuit Court ruled in *Kroske v. US Bank Corp*. that the National Bank Act did not preempt Washington state age discrimination laws. *Kathy Kroske v. US Bank Corp*, 9th Cir. No. 04-35187 (December 23, 2005).

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TILA

- Does Rescission Ever Go Away?
  - Plaintiffs lawyers are sending shotgun rescission notices to Lenders after 2-2.5 years using refi lists.
  - Rescission parameters were part of 1995 TILA negotiations over *Rodash* issue.
  - The 9th Circuit in *King* held in 1986 that after refinance there is nothing to rescind. Good after *Rodash*?
  - TILA clearly states that rescission rights go away after three years or when property is ***sold***.
  - Lenders often use refinance to correct errors.

TILA

- Rescission Case Citations:
  - *Handy v. Anchor Mortgage Corp.*, Nos. 04-3690, 04-4042, 2006 WL 2788500 (7th Cir. Sept. 29, 2006).
    - Inconsistent rescission forms
    - mortgagor had "a right to be returned to the *status quo* that existed before the loan."
  - *Pacific Shore Funding v. Lozo*, 138 Cal. App. 4th 1342 (2006).
    - Refinance does not return borrower to *status quo ante*.
    - Lender does not "have a means of laundering their TILA violations in the initial loan by refinancing it with a second loan . . . . "
    - California Supreme Court has denied review/depublication of the case.
  - *McKenna v. First Horizon Home Loan Corporation*, 429 F.Supp.2d 291 (2006)
    - Class Action.
    - First Horizon didn't use FRB model form.
  - *Barrett v. JP Morgan Chase Bank*, 2006 WL 997231 (6th Cir. 2006).
  - *Mills v. EquiCredit Corp.*, 172 Fed.Appx. 652 (6th Cir 2006).
    - Incorrect form by itself not sufficient grounds for rescission.
  - *King v. State of California*, 784 F.2d 910 (9th Cir. 1986).

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ECOA

- Lending to Seniors:
  - In general, a Lender may not take into account an applicant's age (provided the applicant is 18 years of age or older). A Lender may consider age only to determine an element of creditworthiness based on the particular facts and circumstances concerning the applicant.
  - A Lender may consider the applicant's occupation and length of time to retirement to ascertain whether the applicant's income (including retirement income) will support the loan to its maturity.
  - A Lender is prohibited from making oral or written statements that would have the effect of discouraging applicants/applications for credit based on age. A Lender may relate the applicant's age to other information about the applicant that the creditor considers in evaluating creditworthiness.

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ECOA

- Lending to Seniors:
  - A Lender may consider the adequacy of any security offered when the term of the credit extension exceeds the life expectancy of the applicant and the cost of realizing on the collateral could exceed the applicant's equity.
  - If the term of the loan requested exceeds the actuarial life expectancy of the applicant, a Lender may inquire into whether the collateral would be sufficient to cover the debt and any costs associated with realizing upon the collateral.
  - In considering the applicant's age in determining credit terms, Lender may additionally consider:
    - The actuarial life expectancy of the applicant to become obligated on the transaction (as of that applicant's most recent birthday) can be calculated using the life tables published annually by the IRS. In the case of multiple applicants, the period shall be the actuarial life expectancy of the youngest applicant (as of that applicant's most recent birthday).
    - Review the actuarial life expectancy specified by IRS Publication 590. A higher down payment may also be used to offset risk if the term sought by the applicant is longer than the actuarial life expectancy.

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FACTA

- On August 9, the Federal Trade Commission and the Federal Reserve Board released a report on the success of the consumer dispute provisions of the Fair Credit Reporting Act.
- The study was ordered by the Fair and Accurate Credit Transactions Act of 2003 (FACTA) to examine how well "consumer reporting agencies", and those who provide them with consumer's information (referred to as "furnishers" in the publication), complied with specific FCRA guidelines.
- The authors of the study differed on how well CRAs and furnishers were complying with documentary and investigative requirements, but recommended no legislative or regulatory action until the full effect of FACTA can be seen.
- The study can be read in full at http://www.federalreserve.gov/boarddocs/rptcongress/fcradispute/fcradispute200608.pdf.

Prescreening under the FCRA

- Currently 100-135 class actions pending
- Numerous cases have been decided
- No clear guidance to be gleaned

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Prescreening Checklist

- Tom Cunningham, Lord, Bissell & Brook LLP tcunningham@lordbissell.com
- Control the purchasing of lead lists.
- Determine the prescreening criteria in advance, document it, and do not waver from it.
- Determine the terms of credit and document the terms.

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Prescreening Checklist cont.

- Describe, as much as possible, the credit terms in the solicitation
  - State the product offered (straight ARM, 30 year fixed)
  - State the amount of credit (minimum is allowed)
  - State the rate, or the method used to calculate rate

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Prescreening Checklist cont.

- If there are conditions on extension of credit, disclose them.
- Very few conditions are allowed
  - Sufficiency of collateral
  - No change in condition
  - Verification

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Prescreening Checklist cont

- Ensure that systems can identify the recipients of the prescreened offers and process them properly
  - Use of special code
  - Separate telephone number for response
- Ensure that mailer has opt-out information for opting out of future prescreened offers.

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FCRA Adverse Action

- *Reynolds v. Hartford Fin. Svcs. Group, Inc.*, 435 F.3d 1081 (9th Cir. 2006)
- When an insurance company in evaluating an initial offer of insurance, did not give its very best price because of a credit score, that was an adverse action requiring an adverse action notice.
  - Was this a counter-offer?

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Reynolds

- Failure to provide the notice was considered willful, despite the fact that the only published case law supported the insurance company and the insurance company's actions met the standard industry practices.
- A legal opinion, if "implausible" does not supply a defense

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Reynolds

- The Ninth Circuit also required extra information in the notice such as the exact action taken, the “effect of the action upon the consumer” and the identity of the parties making the decision.
- Cert was granted by the Supreme Court September 26, 2006

GLBA/SOX Readiness

- Vendor Management is the Achilles heel.
- Focus is on IT risk, but vulnerabilities are frequently “old school.”
- Look at EVERYBODY!!!
  - Cleaning Services
  - Security
  - Building
- Encryption v. Security

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Data Breach and ID Theft

- Security is a process, not a series of technical standards. Threats change, business operations change, technologies change. Any specific standard would be obsolete before it was issued. There is less certainty than we might like. This is outweighed by the advantages of having the flexibility to fit a security plan into particular business needs.
- Government should provide as much guidance as possible. There is a fair amount of help out there already, i.e., the federal banking agency guidance on data security.
- How should businesses approach the data security conundrum?
- Start by knowing what consumer information is being collected and how it travels through the organization. Then, determine where the vulnerabilities are.

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Data Breach and ID Theft

- Basic questions (courtesy of Joel Winston of the FTC):
  - Do I need to collect all of the information I am collecting? SSN example
  - What info am I storing and is it really necessary? Magnetic stripe example
  - Which employees have access to sensitive info? Make sure they are properly trained and supervised. Limit access to those who need it.
  - If I share info with third parties, have I addressed the risk that entails? Ensure that service providers are obligated to protect the info. Ensure that customers are legitimate.
  - If I use computers and other technologies to handle the info, do I have basic protections like a firewall, encryption, and anti-virus programs? Make sure that someone competent is handling this aspect of the business and that the protections are updated regularly.
  - Are there specific things about my business model that need to be addressed? For example, if employees have sensitive data on laptops that they take with them.
  - Do I have a process for disposing of info so that it can't be accessed by thieves?
  - How do I respond if there is a breach? Have a plan on whom you will notify, how to close off the vulnerability.
  - Finally, keep in mind that data security is an ongoing process, not a one-time task or a paper exercise.

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Nontraditional Mortgage Guidance

- Affects underwriting, requiring underwriting to fully indexed rate and amortizing payment AND to payment upon recast
- Affects marketing, servicing, training, relationships with third parties, internal reporting, training, and capital requirements.

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Nontraditional Mortgage Guidance

- No Documentation/Stated Income loans are coming under increased scrutiny from regulators and consumer activists.
- Are the loans "reasonable"?
- Useful niche product being abused?

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HMDA

- “They” are watching . . . .
- New(er) rules about providing HMDA data.
- Consumer groups are becoming increasingly sophisticated in their analytics.

Fair Lending

- Center for Responsible Lending Studies
  - Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages, May 31, 2006.
  - The Best Value in the Subprime Market: Sate Predatory Lending Reforms, February 23, 2006.
  - http://www.responsiblelending.org

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Fair Lending

- SouthStar, an Atlanta-based mortgage firm will pay $500,000 to the National Community Reinvestment Coalition (NCRC), pursuant to a settlement negotiated by the Department of Housing and Urban Development (HUD).
- In a complaint filed in March 2006, NCRC alleged that SouthStar employed discriminatory lending polices, including refusing to make loans on any row house valued under $100,000 and any row house in Baltimore, which typically are found in neighborhoods with high populations of African American and Hispanic residents.
- Following an investigation by HUD, SouthStar will
  - (1) discontinue using property type to exclude borrowers;
  - (2) no longer use a minimum property value as an absolute bar to the making of any loan; and
  - (3) change its underwriting guidelines to ensure loans secured by row homes have the same underwriting criteria as loans secured by town homes and condominiums.
  - The official press release can be found at http://www.hud.gov/news/release.cfm?content=pr06-120.cfm.

Advertising and Marketing

- Do you have deceptive marketing practices?
- The FTC and state AGs are focusing on businesses that advertise low teaser interest rates, minimum low-payment plans and often-confusing terms in touting loans.
- TILA advertising requirements and triggering terms are frequently ignored.

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Do Not Fax

- FCC had been planning on eliminating the "established business relationship" exception to Do Not Fax
- This would have required an affirmative opt-in to receiving fax solicitations (such as rate sheets).
- Congress enacted the Junk Fax Prevention Act which created a statutory established business relationship exception.

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Do Not Fax

- On April 1, 2006 new rules enacted, effective August 1, 2006.
- Kept the established business relationship exception
- Requires that the fax number be voluntarily provided or that consent to its distribution was given

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Do Not Fax

- Opt-out Notice Required
  - Must be on first page
  - Must state that the recipient may opt-out and that the sender must comply within 30 days
  - Include a free mechanism that the recipient may use to opt out (email, website, toll-free number)
  - Opt out must be available 24-7

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California Do Not Fax

- Does not have established business relationship exception
- Express permission required
- Applies to intrastate fax transmissions

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Regulation AB

- On December 22, 2004, the Securities Exchange Commission ("SEC") released Regulation AB ("Reg. AB"), a set of final rules that address the registration, disclosure, and reporting requirements for asset-backed securities ("ABS").
- These rules went into effect as of March 8, 2005 and apply only to public transactions that fall within the SEC's definition of ABS.
- To give ABS market participants sufficient time to satisfy all of the requirements set forth by Reg. AB, the SEC established a twelve-month transition period. ABS transactions that are issued after December 31, 2005, will be subject to the new rules.

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Regulation AB

- **Disclosure**: disclosure templates for each of your roles that include master servicer, trustee, back-up servicer and asset servicer.
- **SEC Reporting**: the previous use of Form 8-K for monthly reporting will be replaced with the new Form 10-D, which will include the investor report as an attachment, in addition to supplemental items that must be provided by the depositor, where applicable. The Form 10-K will also include a new reporting item, a management assertion and attestation
  - The 8-K forms will only be used to report atypical events
- **Compliance and Attestation**: Reg. AB requires all parties who are participating in various servicing functions in a transaction to provide a management assertion as to their compliance with a set of applicable servicing criteria as defined in the regulations. Each relevant party must engage an independent accountant to attest to its management assertion. These management assertions and related attestations are in many instances an extension to attestations based on the Uniform Single Attestation Program (USAP) criteria developed by the Mortgage Bankers Association. There are, however, servicing criteria set forth in Reg. AB not previously tested as part of a USAP review, (e.g. the timeliness and completeness of investor reports).
- **Investor Reporting**: Reg. AB provides a list of standard items of significance that need to be reported to investors on a regular basis.

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FLSA

- U.S. Department of Labor (“DOL”) in September released an opinion that mortgage loan officers are exempt administrative employees under the Fair Labor Standards Act (“FLSA”), 29 U.S.C. § 231(a)(1).
- The MBA asked whether mortgage loan officers meet the administrative duties test set forth in 29 C.F.R. § 541.203(b), and whether loan officers meet this standard even though they may use underwriting software programs.
- The DOL’s opinion determined that mortgage loan officers satisfy traditional requirements for the administrative exemption, including exercise of discretion and independent judgment on matters of significant, and performance of non-manual work related to management of the business.
- The opinion also provided that use of software tools in evaluating mortgage products for customers does not disqualify an employee from the administrative employee exception, so long as the loan officer is still responsible for assessing the information and making recommendations to the customer. An exempted employee is not subject to relevant provisions of the FLSA, including payment of overtime.

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FLSA

- Department of Labor Opinion Letter, FLSA 2006-11, March 31, 2006
  - First time the DOL had the opportunity to review a position under its new 2004 outside sales person regulation.
  - At request of NAMB regarding “mortgage loan officers, also referred to as loan originators, who perform their work primarily outside the employer’s offices.” NAMB expressly excluded from its request loan officers who perform their work mainly within the office.
    - Employees who were “customarily and regularly” engaged away from office.
    - Employees did spend some time in employer’s office for meetings, administrative tasks, marketing, etc.

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FLSA

- Department of Labor Opinion Letter, FLSA 2006-11, March 31, 2006
  - DOL concluded that the exempt status of loan officers must be evaluated on an individual basis.
  - NAMB examples met the outside sales force exemption.
  - DOL three key criteria:
    - Principal activity is sales;
    - They "customarily and regularly" work outside their employer's place of business; and
    - Many of the activities which they perform at their employer's place of business are "incidental to and in conjunction with" their principal duty of outside sales.

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FLSA

- Department of Labor Opinion Letter, FLSA 2006-11, March 31, 2006
  - DOL discusses and clarifies the new "primary duty" requirements of the exemption:
    - how the DOL would address situations where certain work is performed in the employer's office and how such work can qualify as exempt so long as the activities are "incidental and in conjunction with" an employee's own sales.
  - What is critical about the opinion:
    - while the DOL found that the loan officers spent a "significant amount of time" away from the employer's business, they also found that certain inside activities performed at the employer's place of business did not disqualify the employees for the outside sales exemption.

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California Telecommunications

- *Kearney v. Salomon Smith Barney*, 2006 WL 1913155 (Cal. 2006).
- California telephone recording rules (which require the consent of both parties) apply to calls with California customers, regardless of where the call is from or to.
- An announcement that the call may be recorded is sufficient.

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Other Items of Interest

- California Elder Abuse goes into effect January 1, 2007.
- Illinois 4050 went into effect in September and seems to be working.
  - Coming soon to a state near you?

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RESPA

- Are we ever going to see RESPA reform?
- Renewed reliance on interpretive letters.
- We may see more enforcement though:
  - HUD has tripled its staff and doubled its budget in the last three years, and is currently pursuing 60 investigations into possible Section 8 violations.

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Title Insurance

- Many new suits alleging that borrowers paid more in title insurance premiums so that their providers could cover the costs of incentives given to realty professionals in exchange for referrals.
- Colorado, California, Washington, New York and other state Departments of Insurance have been conducting their own investigations of the title insurance industry.
- The National Association of Insurance Commissioners has suggested that the practice is widespread and has encouraged state regulators to investigate the practice in their individual states.

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Title Insurance

- In response to an increasing number of state and federal investigations into the title insurance industry, the House Committee on Financial Services Chairman Michael Oxley requested the General Accounting Office ("GAO") to conduct a comprehensive study of the title insurance industry.
- In requesting the study, the Committee cited the recent rash of investigations that found many title companies were making payments to lenders and builders in violation of the Real Estate Settlement Procedures Act ("RESPA") and their having engaged in other anti-competitive practices.
- The Committee requested that the GAO:
  - (1) Analyze factors that impact the price of title insurance;
  - (2) determine how the product is marketed and to what extent consumers would benefit from a more competitive marketplace; and
  - (3) examine the relationship between title insurers, realtors, builders and lenders to determine whether such relationships promote anti-competitive practices.

Title Insurance

- The GAO found that the extent to which premium rates reflect actual costs or risks is unclear because:
  - (1) Many state regulators do not determine whether premium rates accurately reflect the insurers' costs;
  - (2) insurers may provide discounted premiums in refinance transactions to reflect the short period of time the title search covers but it is not clear the extent such discounts are applied; and
  - (3) the correlation between premium rate increases and higher loan amounts is unclear as costs for title search and examination do not appear to rise as loan or purchase amounts increase.
- The report identified two primary types of illegal activities in the sale of title insurance:
  - fees that title agents give to builders, real estate agents, brokers or lenders in return for referrals, and
  - the mishandling of customers' title insurance premiums.
- Insurance regulators in several states have identified captive reinsurance arrangements used to inappropriately compensate builders or lenders for referrals.

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Captive Reinsurance

- Under a captive reinsurance agreement, a title underwriter or private mortgage insurer (“PMI”) pays part of the insurance premium to a reinsurance company that is owned by another company.
- Captive title and PMI reinsurance agreements are currently undergoing federal and state regulatory scrutiny under RESPA and state laws.

Captive Reinsurance

- HUD announced settlements totaling $1.95 million from three companies in October 2006 and $1.6 million from two companies in July 2006.
  - HUD said the home builders violated the Real Estate Settlement Procedures Act by using companies they owned or were affiliated with to "reinsure" title insurance policy.
  - HUD officials say such arrangements are designed to generate referral fees and that reinsurance companies pay few or no claims.
  - "In HUD's view, any captive title reinsurance arrangements in which payments are not bona fide and exceed the value of the reinsurance are a violation of RESPA,"
  - Brian Montgomery, HUD Assistant Secretary for Housing, said in July announcement that "[t]here is almost never any legitimate need or business purpose for title reinsurance on a single-family residence."
- Risk mitigation v. risk assumption: is there a transfer of risk? Measurable?
- RESPA does not include a reference to authoritative literature for evaluating risk

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Compliance

- The New Challenges:
  - Determining the scope of the compliance function
  - Choosing the right structure
  - Reporting meaningful information
  - Establishing and enforcing a consistent approach
  - Understanding the enterprise context
- Legal Role: knowledge and analysis
- Compliance Role: systems and procedures

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Compliance

- Who?
  - Level: Enterprise-wide focus
  - Process: Risk management discipline
  - Scope: Laws, rules and standards
  - Relationship to business line: Independence
  - Key skill set: Judgment and communication
- What?
  - Policy Focus
  - Substantive Competence
  - Administrative Competence
- Why?
  - COSO framework for compliance risk management
    - Not limited to compliance
  - Basel II
    - Coordination across risk management functions
  - Ethics
    - Regulatory sensitivity
    - Director sensitivity
  - Market forces
    - Advances in analytical methods and technology
    - External stakeholders
      - Solely relying on compliance officers fall short here.

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Compliance

- How to respond to regulatory concerns:
  - Establish or enhance policies and procedures for new product approvals and individual transaction approval.
  - Establish policies and procedures with particular attention to those specifically targeted at regulations presenting highest risk.
  - Enhanced senior management and board reporting.
  - Clarified responsibilities of various individuals and functions.
    - Unfunded mandates
    - Accountability without responsibility
    - Deming: "What gets measured gets done." A pejorative.
  - Refined sales practices.
  - More formal consideration of reputational risk.

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