[an error occurred while processing this directive]
who want to participate in and enhance Committee activities. There are a
to number of women and minorities holding leadership positions and playing
other important roles on the Committee, and we are committed to offering
opportunities for leadership and participation to all CFSC members,
regardless of race, gender, religion, national origin, marital status, age, sexual
orientation or disability. We recognize that many CFSC members are unable to
attend our meetings, but all members can become involved in Committee
activities and projects through newly expanded opportunities, such as this
eNewsletter and the Financial Literacy Education Clearinghouse. If you want
to learn more about CFSC member benefits and or become more active in the
Committee, please contact the Membership Subcommittee Chair or Vice-
Chair, Joe Looney (jlooney@hudco.com; 410-865-5436) and Julie Caggiano
(jcaggiano@hwallp.com; 713-759-0818), respectively. Elizabeth Yen
(ecyen@hudco.com; 203-776-1911), the CFSC Liaison to the Section
Division Committee, can explain the Section's and the CFSC's initiatives to
promote greater diversity and help you become more involved.

- **Winter 2005 Committee Meeting.** I am excited to announce that our Winter
  2005 stand-alone Committee Meeting is set for January 13-16, 2005 at the
  Sonesta Beach Resort on the ocean in Key Biscayne, Florida. The resort is
  near Miami, South Beach and other popular area locations. The Meeting will
  begin with an outdoor reception on Thursday, January 13 from 6:30 to 8:30
  p.m. and conclude on Sunday, January 16 around 11:00 a.m. The Committee
  meets at ski resorts and warm-weather venues in alternating years.

  David McCrea, who is fortunate to live and practice in Miami, and his wife
  Janet deserve our thanks for touring and recommending hotels and offering
  many insights on the area. I have been especially sensitive to keeping costs
down while still securing high-quality accommodations and facilities. The hotel
base room rate is $235 per night, $60 per night lower than our rate in Park
City/Deer Valley this past January. The Sonesta Beach offers golf, tennis, a
large beach and swimming pool and many other activities and amenities. You
should receive meeting registration, hotel reservation and other forms and
information early in the fall.

- **NCCUSL Drafting Committee on Uniform Debt Counseling Act.** Carla Witzel
  (cwitzel@gfrawlaw.com; 410-576-4192) is the new ABA/Section Advisor to this
  Drafting Committee. The Committee will meet shortly before the Annual
  Meeting, and Carla will provide a report in time for the Meeting. Please contact
  Carla if you wish to contribute to the drafting process and/or learn the status of
  this effort.

- **Ad Hoc Committee on Audit Responses.** Finally, Richard Gottlieb
  (rgottlieb@dykema.com; 312.627.2196) is the CFSC Representative to this
  new Section Committee. If you want to learn about the Committee's charge,
  assist Richard in his role and/or follow the Committee's progress, please
  contact him.

I would appreciate your feedback on this column and our first eNewsletter. Please feel
free to let Rick or me (ilanger@dltlaw.com; 614.628.1602) know what you would like
the eNewsletter to address and let me know what CFSC, Section and/or ABA matters
you want me to cover in my column. This is your eNewsletter, and we want it to be
engaging and valuable. I hope to see you soon in Atlanta and look forward to
receiving your input, thoughts and suggestions!

Jeffrey I. Langer
Dreher Langer & Tomkies LLP
Chair, Consumer Financial Services Committee
ABA Section of Business Law

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**Feature Articles**

**FACT Act Update**
by L. Richard Fischer and Nathan D. Taylor
Morrison & Foerster LLP

On December 4, 2003, President George W. Bush signed into law the
Fair and Accurate Credit Transactions Act of 2003 ("FACT Act"). The
FACT Act permanently reauthorized the existing national uniformity provisions of the Fair Credit Reporting Act ("FCRA"), and amended the FCRA to strengthen the national credit reporting and credit granting systems and to assist both consumers and financial institutions in fighting identity theft.

The driving impetus behind the FACT Act was the impending sunset of the existing FCRA preemption provisions on January 1, 2004 and the potential disruption of the national credit reporting and credit granting systems that could ensue. In order to complete the legislative process by the end of 2003, Congress granted significant rulewriting authority to a combination of federal agencies. In fact, twenty FACT Act provisions direct or permit various federal agencies, including the Federal Trade Commission ("FTC") and the federal banking agencies, to write rules and regulations. As a result, although the FACT Act amendments will have a substantial impact on the credit reporting and credit granting processes, the exact impact on consumers, financial institutions and consumer reporting agencies ("CRAs") will not be fully understood until the various rulewriting efforts have been completed.

More...

ECOA/Auto Finance Class Action Lawsuits
by Stephen G. Harvey
Pepper Hamilton LLP

At the ABA Section of Business Law 2004 Spring Meeting in Seattle, the Consumer Litigation Subcommittee presented a program entitled "Fair Lending and Auto Finance: Is There a Case for Discrimination?" The speakers were Thomas M. Byrne of Sutherland Asbill & Brennan LLP; Peter N. Cubita of Weil, Gotshal & Manges LLP; Glenda Gill of Operation Push Automotive Project; Stephen G. Harvey of Pepper Hamilton LLP; Stuart Rossman of the National Consumer Law Center; and Nina Simon of AARP as moderator.

The program explored some of the issues raised by the numerous class action lawsuits alleging violations of the Equal Credit Opportunity Act ("ECOA") that have been filed in federal court against banks and finance companies that engage in the business of indirect automobile finance, including General Motors Acceptance Corp., Nissan Motor Acceptance Corp., Toyota Motor Credit Company, Ford Motor Credit Company, DaimlerChrysler Services North America LLC, Bank One, Bank of America, PRIMUS, Wells Fargo, American Honda Finance Company, WFS Financial, Firstar, U.S. Bank, Union Acceptance Corporation, and Am South Bank.

The Plaintiffs' Legal Theory

The legal theory advanced in each of the cases is identical. Borrowing concepts developed in the employment discrimination context under Title VII, the plaintiffs claim that the defendant has a policy of "authorizing" car dealers to "markup" an objective financing rate set by the bank or finance company and that statistical analysis will show, the plaintiffs claim, that the policy causes African Americans or Latinos to pay more "markup" than similarly situated whites. Thus, plaintiffs alleges, even though the credit scoring system used by the banks and finance company is objective (i.e., non discriminatory), the alleged policy of authorizing dealers to make credit pricing decisions unintentionally results in discrimination.

More...

Justice Settles 'Redlining' Suit Against Old Kent Bank
by Steven Zeisel
Consumer Bankers Association

On May 19, 2004, the Department of Justice settled a suit against Old Kent Financial Corporation and Old Kent Bank ("the Bank" or "Old Kent") for alleged Fair Lending violations by "redlining" in its residential real estate and commercial lending in Michigan between 1996 and 2000. Old Kent has since been acquired by Fifth Third Bank, which
was not named in the complaint. Under the terms of the settlement agreement, which must still be approved by the court, the Bank, which has denied any wrongdoing, will invest $3 million in a special financing program over the next three years, invest $200,000 in financial education, and open three new branches in Detroit.

The Justice Department's complaint alleged that the Bank, while expanding its business throughout the Detroit area, engaged in a pattern of locating branches to serve predominantly white areas, and largely avoided predominantly African American neighborhoods. According to the complaint, by March 2000, Old Kent had opened 53 branches in the Detroit metropolitan area but none in the City of Detroit, where the majority of the population was African American.

The Justice Department further alleged that, during the years in question, the Bank funded very few loans, either small business or residential real estate related, to residents of the City of Detroit, and that the Bank did not solicit applications from within the City of Detroit to the same degree as from other census tracts. The complaint noted that the Bank's Community Reinvestment Act assessment area excluded the City of Detroit.

More...

**DIDMCA Preemption Revisited in Illinois Case**

by John L. Ropiequet
Arnstein & Lehr LLP

A recent decision of the Illinois Appellate Court, First District, *U.S. Bank N.A. v. Clark*, 2004 Ill. App. Lexis 335 (Mar. 31, 2004), pet. for leave to appeal filed, No. 98379 (May 5, 2004), has created turmoil for mortgage lenders who do business in Illinois. The court held that a 1992 amendment to a provision of the Illinois Interest Act overrode preemption of interest and points caps under Section 501(a)(1) of DIDMCA. Thus, a 3-point cap on points for all mortgage loans with interest rates over 8% dating back to 1974, which lenders thought was a dead letter because of DIDMCA preemption in 1980 and a 1981 amendment to the Interest Act, was held to be fully applicable to all mortgage loans issued in Illinois after the effective date of the 1992 amendment. Absent reversal by the Illinois Supreme Court, this decision creates major problems for lenders which have existing Illinois loan portfolios or which issue new mortgage loans in Illinois.

DIDMCA preempted all state usury limits on first lien mortgage loans in 1980, unless states adopted legislation within a three-year period to opt out or unless they adopted new legislation to override the preemption. Illinois did not opt out, so DIDMCA preemption was considered to apply to first lien mortgage loans for Illinois borrowers.

More...

**Preemption and Federalism Update**

by Jonathan D. Jaffe, Kirkpatrick & Lockhart LLP
and Michael C. Tomkies, Dreher Langer & Tomkies LLP

Things have been busy on the preemption and federalism front since the Office of the Comptroller of the Currency (OCC) issued two long-awaited final rules on national bank preemption and visitorial powers on January 7, 2004. The first rule clarified what types of state laws apply to national banks, while the second clarified issues related to the OCC's exclusive visitorial powers over national banks. Both rules took effect February 12, 2004. 69 Fed. Reg. 1895 (visitorial powers); 69 Fed. Reg. 1904 (preemption). In response to the rule, Congress has held hearings in both the Senate and the House, and the House passed an amendment expressing concern over the scope of the rules. The courts have already begun to issue decisions on previously filed actions that may indicate the general direction of judicial thinking on the rules. New actions have been filed challenging the OCC's authority and a variety of decisions continue to outline the implications of preemption authority for state and national banks in various areas.
Web links to items discussed in this eUPDATE and other preemption and federalism-related materials can be found on the Joint Preemption Task Force web page sponsored by the Consumer Financial Services Committee and the Banking Law Committee.  

More...

### Washington Update - Capitol Hill Report

**by Frank Salinger**  
*Advanta Corporation*

In the world of lobbying nothing is more challenging than an election year. With the early resolution of the presidential primaries, the parties have started what passes for political discourse today. You know, the Democrats are all godless libertines and the Republicans, after a long day of reading the bond tables in *Barron’s*, relax by shooting orphans from their verandahs. As for Ralph Nader-- oh well, I can’t even think of anything to match his alternative reality.

Meanwhile, on Capitol Hill, in both the House Financial Services and Senate Banking Committees, consumer financial services legislation has been on the back burner—especially after last year's passage of the FACT Act. Earlier this year most of the attention focused on legislation dealing with oversight of housing-related government sponsored entities (such as Freddie Mac, Fannie Mae and the regional home loan banks), however, this has now stalled in the Senate.

Because of this, Congress has turned its attention to two other, more-structural, issues: "Regulatory Relief" and FDIC Reform. In the case of Regulatory Relief, most of the provisions under consideration come from the federal banking agencies and the Conference of State Bank Supervisors (the professional society of state bank commissioners), hence it has been described by some on the Hill as "Regulators' Relief.”

More...

### Subcommittee Updates

#### Compliance Management Subcommittee

The Compliance Management Subcommittee, chaired by Robin Warren, was formed in 2003 in response to the increasingly important role that compliance management plays in the Business Law community. The subcommittee sponsored a panel at the Spring 2004 Business Law Committee meeting in Seattle on "Organizational Structures for Managing Compliance" which included an illuminating discussion with representatives of the Office of the Comptroller of the Currency on managing compliance examinations. In conjunction with the Privacy Subcommittee, a Committee Forum titled "The FACTs of Life - Implementing Compliance with the Fair and Accurate Credit Transactions Act" will be presented at the ABA’s Annual Meeting in Atlanta in August. More details can be found below under "Preview of CFSC Meetings & Programs at the 2004 Annual Meeting".

#### Debt Collection Practices and Bankruptcy Subcommittee

Servicemembers Civil Relief Act Amends Soldiers' and Sailors' Civil Relief Act. Collection agencies should be aware of the recent amendments to the Soldiers' and Sailors' Civil Relief Act. The purpose of the Act is to temporarily suspend judicial and administrative proceedings that may adversely affect the civil rights of servicemembers during their military service. Before a default judgment can be entered against any servicemember, the plaintiff is required to file an affidavit with the court stating whether or not the defendant is in military service and showing the necessary facts to support the affidavit. If the plaintiff is unable to make such a determination, then the affidavit must so state and the court may
require the plaintiff to post a bond to indemnify the defendant in the
event the defendant is protected by the Act. There are criminal
penalties for knowing violations and civil penalties, including void
judgments, for unknowing violations.

The Department of Defense has set up a web site database in which
subscribers (subscription is free) can enter the name or social security
number of a defendant and receive certification as to whether the
person is a servicemember. The web site is located at:
https://www.dmdc.osd.mil/udpdr/owa/sscrapage. You must first obtain
a user ID and password by faxing a request to Mr. Jim McCloud,
DMDC-East, Defense Manpower Data Center, 1600 Wilson Blvd.,
Suite 400, Arlington VA 22209-2593, Phone 703-696-5844, Fax 703-
696-1461. Ask for the DMDC Military Verification Web Application and
follow the instructions upon receipt.

Preemption and Federalism Subcommittee

Things have been busy on the preemption and federalism front since
the Office of the Comptroller of the Currency (OCC) issued two long-
awaited final rules on national bank preemption and visitorial powers
on January 7, 2004. The first rule clarified what types of state laws
apply to national banks, while the second clarified issues related to the
OCC's exclusive visitorial powers over national banks. Both rules took
effect February 12, 2004. 69 Fed. Reg. 1895 (visitorial powers); 69

In what may be the first preemption decision rendered since the new
OCC rules became effective, the United States District Court for the
Northern District of Ohio found that the National Bank Act and
corresponding federal regulations preempted a portion of the Ohio
Retail Installment Sales Act (RISA). Abel v. KeyBank USA, N.A., 313 F.
Supp. 2d 720 (N.D. Ohio 2004). The plaintiffs claimed a violation of
Ohio's holder in due course rule, which is codified as part of the Ohio
RISA. The rule permits a buyer to assert defenses against a holder of a
purchase money loan installment note and to assert these defenses as
affirmative claims. See Ohio Rev. Code § 1317.032.

The United States District Court for the District of Connecticut, in what
appears to be the first ruling involving the OCC's visitorial powers rule,
has concluded that if a state regulation interferes with a national bank's
operation of the business of banking through an operating subsidiary,
a power which national banks are authorized to exercise, then that
state regulation is preempted. See Wachovia Bank, N.A. v. Burke, No.

These and other developments will continue to be followed and
discussed in upcoming subcommittee meetings and programs.
Additional details on these issues may be found in the Preemption and
Federalism Update article below.

Privacy Subcommittee

The California legislature seeks to expand when agencies and
companies must give notice of a security breach. SB 1279 will require
that notice be given to a California resident when his/her data, that
includes personal information, is the subject of a security breach.
Current law only requires notice when unencrypted computerized data
(that includes personal information) is breached, and only when the
information was, or is reasonably believed, to have been acquired by
an unauthorized person. SB 1729 will require that notice be given for a
data breach in any medium. The prerequisite of the data being
acquired, or reasonably believed to have been acquired, by an
unauthorized person has also been removed. A security breach is
defined as unauthorized acquisition of data that compromises the
security or confidentiality of the personal information.
In Schuchart v. Taberna del Alabardero, 365 F. 3d 33 (D.C. Cir. 2004), the District of Columbia Court of Appeals will likely decide whether a business can be held liable for disclosing a customer's credit card information to a third party. The alleged invasion of privacy is based on the tort of intrusion upon seclusion (Restatement of Torts §652B). The plaintiff, Catherine Schuchart, ate at the D.C. restaurant, La Taberna del Alabardero, and paid with her personal credit card. Without Ms. Schuchart's consent, La Taberna del Alabardero provided her employer with a copy of her credit card receipt. Ms. Schuchart sued alleging invasion of privacy for the disclosure of her personal information and dining habits. The U.S. Court of Appeals, District of Columbia Circuit, certified the following questions: "Does a customer state a claim for intrusion upon seclusion, or another common law tort, where (1) a business discloses without consent a customer's personal credit card information to a third party not involved in processing payment (specifically, the customer's employer), and does the result differ if the credit card information is disclosed to a party who already possesses that information, and (2) a restaurant discloses to a third party the dining habits of a patron without the patron's consent?"

Truth in Lending Subcommittee

The United States Supreme Court has determined that over-limit fees are not finance charges under the Truth in Lending Act. Creditors routinely impose over-limit fees on credit card and other open end accounts. They charge the fee when a consumer requests an advance that exceeds the credit limit on the account. In most cases, the creditor also honors the request for the advance. So, the over-limit fee has characteristics associated with both a default fee (not a finance charge) and a transaction fee (a finance charge). The decision rests on the following points:

- The Act does not specify that over-limit fees must be classified as finance charges.
- The Act delegates to the Federal Reserve Board ("FRB") the power to make regulations.
- The Board has issued regulations (Regulation Z) specifying that over-limit fees are not finance charges.
- Those regulations are not arbitrary, capricious or manifestly contrary to the Act.

The case is significant for two reasons. First, creditors will continue to be able to charge over-limit fees without disclosing the fee as a finance charge on monthly billing statements. Second, the case reinforces the principle that courts should defer to the rules established by the FRB in Regulation Z. The decision overturned a Sixth Circuit decision that held that creditor ought to treat over-limit fees as finance charges if they routinely permit the consumer to exceed a credit limit. For more information, see Household Credit Services, Inc. v Pfennig, 124 S.Ct. 1741 (April 21, 2004).

Calendar

Preview of CFSC Meetings & Programs at the 2004 Annual Meeting

Annual Meeting time is here and the Consumer Financial Services Committee meetings, programs, and forum should be excellent! We will meet at the Atlanta Hilton in Grand Ballroom A (second floor) beginning at 8:30 a.m., Saturday August 7, 2004. Meetings on our schedule conclude at 4:30 p.m., Monday August 9. Click here for a full schedule of CFSC meetings and programs.

Our programs and forum will be timely and insightful. We start on Saturday morning with "The FACTs of Life: Implementing Compliance with the Fair and Accurate Credit Transactions Act of 2003." Panelists will describe steps financial services providers are taking to implement compliance with the wide array of new
requirements imposed by the FACT Act, including customer
tonifications, standards for users of consumer reports, obligations for
furnishers of information to consumer reporting agencies, and new
duties owed to victims of identity theft.

Throughout the remainder of the weekend we will follow a "mini-
theme" and our subcommittee meetings will address additional
aspects of the FACT Act that are of particular importance to the
consumer financial services industry. Click here for more information
on our Fact Act Mini-Theme.

On Sunday morning we will continue our valuable programs with "Wal-
Mart v. Visa/MasterCard: Winners, Losers, and Collateral Damage
in the Debit Card Business." Because of the Wal-Mart settlement,
merchants need not accept all types of VISA or MasterCard-branded
cards, and interchange fees on certain debit products are reduced. But
this settlement forces changes beyond rewriting rules and cost
reductions. This program examines the settlement's effects on the card
associations, issuers, transaction acquirers, networks, merchants and
consumers and where these effects may lead.

On Monday morning we will complete our programs with "Consumer
Protection vs. Competition: The Raging Debate on a Lawyer's Role
and Ethical Responsibilities in Residential Real Estate
Transactions." This program addresses the active debate on whether
lawyers are necessary to protect consumers’ rights or just add
unnecessary costs in residential real estate transactions. Our panel will
discuss the role of lawyers and recent judicial decisions in this area. Of
special note, this program will provide TWO hours of ethics continuing
education.

Also not to be missed: CFSC is cosponsoring three additional
programs at the Annual Meeting: "Getting Paid in the 21st Century:
Gift Cards, Stored Value Cards, Mobile and Contactless Payments,
and Other Species of Electronic Money Transmission," sponsored by the
Cyberspace Law Committee; "How to Draft Consumer and
Employee Arbitration Agreements That Will Withstand Attack,"
sponsored by the Ad Hoc Committee on Consumer Arbitration; and
"Annual ADR Update: Important Changes in U.S. and International
Arbitration Law," sponsored by the Dispute Resolution Committee.

Click here for a full schedule of CFSC meetings and programs.

Join us for these exceptional programs! See you in Atlanta.

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<th>Schedule of Upcoming Meetings</th>
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<tr>
<td><strong>Annual Meeting 2004</strong></td>
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Mind the FACTs:
The Impact of the Fair and Accurate Credit Transactions Act of 2003 on the Consumer Financial Services World

American Bar Association Annual Meeting
August 7 – 9, 2004
Atlanta Hilton, Grand Ballroom A, Second Floor

Learn how the FACT Act will affect every aspect of the consumer financial services industry.

We will have a 2 hour forum focusing on FACT Act compliance and implementation issues, along with individual subcommittee presentations addressing FACT Act provisions of particular importance to specific consumer financial services subject areas.

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<th>Schedule of FACT Act Presentations</th>
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<td><strong>Monday, August 9</strong></td>
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SATURDAY, AUGUST 7, 2004

8:30-9:00 am  **WELCOME**

Chair: Jeffrey I. Langer, Dreher Langer & Tomkies L.L.P., Columbus, OH  
Vice Chair: Marjorie A. Corwin, Gordon, Feinblatt, Rothman, Hoffberger & Hollander, Baltimore, MD  
Vice Chair: Stanley D. Mabbitt, Stinson Morrison Hecker LLP, Phoenix, AZ  
Vice Chair: Donald C. Lampe, Womble Carlyle Sandridge & Rice, PLLC, Greensboro, NC

9:00-9:45 am  **ACCESS TO SERVICES**

Chair: Jeffrey P. Bloch, Credit Union National Association, Washington, DC  
Vice Chair: Heather Thayer, Fredrikson & Byron, Minneapolis, MN

9:45-10:30 am  **ALTERNATIVE DISPUTE RESOLUTION**

Chair: Eric J. Mogilnicki, Wilmer Cutler Pickering LLP, Washington, DC  
Vice Chair: Daniel Hedges, Mountain State Justice, Charleston, WV

10:30 am-12:30 pm  **COMMITTEE FORUM: THE FACTS OF LIFE: IMPLEMENTING COMPLIANCE WITH THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003**

Co Chair: Robin K. Warren, Bank of America Corporation, Charlotte, NC  
Co Chair: Joan P. Warrington, Morrison & Foerster LLP, New York, NY

12:30-1:30 pm  Lunch

1:30-2:00 pm  **TRUTH IN LENDING**

Chair: Timothy P. Meredith, Hudson Cook LLP, Linthicum, MD  
Vice Chair: Barbara S. Mishkin, Reed Smith LLP, Philadelphia, PA

2:00-2:30 pm  **HOUSING FINANCE AND RESPA**

Chair: Walter E. Zalenski, Weil, Gotshal & Manges LLP, Washington, DC  
Vice-Chair: Robert M. Jaworski, Reed Smith LLP, Princeton, NJ
Vice-Chair: Joseph M. Kolar, Buckley Kolar LLP, Washington, DC

2:30-4:30 pm  **CYBERSPACE LAW COMMITTEE PROGRAM:**  *Getting Paid in the 21st Century: Gift Cards, Stored Value Cards, Mobile and Contactless Payments and Other Species of Electronic Money Transmission*

(Transcript: Consumer Financial Services Committee and Science and Technology Section)

**Chair:** Robert H. Ledig, Fried, Frank, Harris, Shriver & Jacobson, Washington, DC
**Co-Chair:** Judith E. Rinearson, Katten, Muchin, Zavis & Rosenman, New York, NY
**Co-Chair:** Anita Ramasastry, University of Washington School of Law, Seattle, WA

4:30-5:30 pm  **PERSONAL PROPERTY FINANCING**

**Chair:** Peter N. Cubita, Weil, Gotshal & Manges LLP, New York, NY
**Vice Chair:** Mark S. Edelman, McGlinchey Stafford, Cleveland, OH
**Vice Chair:** Thomas J. Buiteweg, GMAC Financial Services, Detroit, MI

8:00 pm  Committee Dinner

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**SUNDAY, AUGUST 8, 2004**

8:00-10:00 am  **JOINT PRIVACY TASK FORCE**

(Transcript: Consumer Financial Services, Banking Law and Cyberspace Law Committees)

**Co-Chair:** Raymond J. Gustini, Nixon Peabody LLP, Washington, DC
**Co-Chair:** Joan P. Warrington, Morrison & Foerster LLP, New York, NY
**Co-Chair:** David J. Wiese, Tyler Cooper & Alcorn LLP, Hartford, CT

10:00-10:15 am  **COMMITTEE MEETING**

**Chair:** Jeffrey I. Langer, Dreher Langer & Tomkies L.L.P., Columbus, OH

10:15-10:30 am  **COMPLIANCE MANAGEMENT**

**Chair:** Robin K. Warren, Bank of America Corporation, Charlotte, NC
**Vice Chair:** Agnes Bundy Scanlan, FleetBoston Financial, Boston, MA
10:30 am-12:30 pm **Program:** *Wal-Mart v. MasterCard/VISA: Winners, Losers and Collateral Damage in the Debit Card Business*

(Co-Sponsored By Antitrust Committee)

**Chair:** Richard P. Hackett, Pierce Atwood, Portland, ME

12:30-1:30 pm Lunch

1:30-3:00 pm **Joint Subcommittee Meeting**

**Debt Collection Practices and Bankruptcy**

**Chair:** Therese G. Franzén, Franzén and Salzano PC, Norcross, GA  
**Vice Chair:** Bruce N. Menkes, Mandell Menkes & Surdyk LLC, Chicago, IL

**Federal and State Trade Practices**

**Chair:** Jean Noonan, Hudson Cook LLP, Washington, DC  
**Vice Chair:** Muzette Hill, Ford Motor Credit, Dearborn, MI

**AND**

1:30-3:00 pm **Ad Hoc Committee on Consumer Arbitration Program: How to Draft Consumer and Employee Arbitration Agreements That Will Withstand Attack**

(Co-Sponsored By Consumer Financial Services Committee and Dispute Resolution Committee)

**Co Chair:** Alan S. Kaplinsky, Ballard Spahr Andrews & Ingersoll, LLP, Philadelphia, PA  
**Co Chair:** Terry L. Trantina, Stern & Kilcullen LLP, Roseland, NJ

3:00-4:30 pm **Joint Subcommittee Meeting**

**Consumer Litigation**

**Chair:** Nina F. Simon, AARP Foundation, Washington, DC  
**Vice Chair:** Stephen G. Harvey, Pepper Hamilton LLP, Philadelphia, PA

**Preemption and Federalism**

**Chair:** Jonathan D. Jaffe, Kirkpatrick & Lockhart LLP, San Francisco, CA  
**Vice Chair:** Michael C. Tomkies, Dreher Langer & Tomkies L.L.P., Columbus, OH
4:30-5:30 pm **LEADERSHIP MEETING**

Chair: Jeffrey I. Langer, Dreher Langer & Tomkies L.L.P., Columbus, OH

**MONDAY AUGUST 9, 2004**

8:00-10:00 am **PROGRAM: CONSUMER PROTECTION VS. COMPETITION: THE RAGING DEBATE ON A LAWYER’S ROLE AND ETHICAL RESPONSIBILITIES IN RESIDENTIAL REAL ESTATE TRANSACTIONS**

Chair: Richard P. Eckman, Pepper Hamilton LLP, Wilmington, DE

10:00-10:30 am **OPEN MICROPHONE SESSION**

Moderator:
Marjorie A. Corwin, Gordon, Feinblatt, Rothman, Hoffberger & Hollander, Baltimore, MD

10:30 am-12:30 pm **JOINT SUBCOMMITTEE MEETING**

**DEPOSIT PRODUCTS AND PAYMENT SYSTEMS**

Chair: Margaret B. Crockett, Goodwin Procter LLP, Boston, MA
Vice Chair: Oliver I. Ireland, Morrison & Foerster LLP, Washington, DC

**INTERNET DELIVERY/ELECTRONIC BANKING**

Chair: Richard P. Hackett, Pierce Atwood, Portland, ME
Vice Chair: Roberta G. Torian, PNC Bank, Philadelphia, PA

2:30-4:30 pm **DISPUTE RESOLUTION COMMITTEE FORUM: ANNUAL ADR UPDATE: IMPORTANT CHANGES IN U.S. AND INTERNATIONAL ARBITRATION LAW**

(Co-Sponsored By Business and Corporate Litigation Committee, Consumer Financial Services Committee and Ad Hoc Committee on Consumer Arbitration)

Chair: Terry L. Trantina, Stern & Kilcullen LLP, Roseland, NJ

4:30 pm Adjourn
FEATURE ARTICLES

FACT ACT UPDATE
by L. Richard Fischer and Nathan D. Taylor
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On December 4, 2003, President George W. Bush signed into law the Fair and Accurate Credit Transactions Act of 2003 (“FACT Act”). The FACT Act permanently reauthorized the existing national uniformity provisions of the Fair Credit Reporting Act (“FCRA”) and amended the FCRA to strengthen the national credit reporting and credit granting systems and to assist both consumers and financial institutions in fighting identity theft.

The driving impetus behind the FACT Act was the impending sunset of the existing FCRA preemption provisions on January 1, 2004 and the potential disruption of the national credit reporting and credit granting systems that could ensue. In order to complete the legislative process by the end of 2003, Congress granted significant rulewriting authority to a combination of federal agencies. In fact, twenty FACT Act provisions direct or permit various federal agencies, including the Federal Trade Commission (“FTC”) and the federal banking agencies, to write rules and regulations. As a result, although the FACT Act amendments will have a substantial impact on the credit reporting and credit granting processes, the exact impact on consumers, financial institutions and consumer reporting agencies (“CRAs”) will not be fully understood until the various rulewriting efforts have been completed.

Several important FACT Act rulewritings have been instituted since the FACT Act was signed into law and many others are expected to be commenced in the near future. For example, on February 4, 2004, the Federal Reserve Board (“FRB”) and the FTC finalized the initial FACT Act rulewriting by establishing effective dates for FACT Act provisions where effective dates were not specified in the statute itself. For those provisions of the FACT Act that required substantial implementation efforts, the FRB and the FTC established a December 1, 2004 effective date. In addition, the FRB and the FTC established December 31, 2003 as the effective date for the critical FACT Act preemption provisions, thereby ensuring that the existing FCRA preemption provisions, originally established by Congress nearly a decade ago, would not sunset. However, statements made by the FRB and the FTC in the supplemental information to that rule explained that notwithstanding the December 31, 2003 effective date, existing state laws that eventually would be covered by the new preemption provisions would remain in effect until conduct was required by the new identity theft provisions or subject matter was regulated under other new FACT Act substantive provisions.

On June 4, 2004, the FTC issued a final rule to implement the new consumer right to obtain a free annual consumer report. The rule would require nationwide CRAs to establish and operate a “centralized source” to enable consumers to make one request by various means to obtain a free annual consumer report from each nationwide CRA. This rule, which will phase in over a nine month period beginning December 1, 2004, may have a collateral effect on financial institutions if the increased availability of free consumer reports increases consumer disputes concerning the accuracy of information contained in those reports and thereby increases the duty of financial institutions to investigate disputed information, either directly or through CRAs.
On June 9, 2004, the FRB issued a final rule to implement the FACT Act requirement that financial institutions notify borrowers, either before or within 30 days after, furnishing negative information to CRAs about loans. Importantly, the rule provides two model notices, one that can be provided to borrowers in advance of reporting negative information and one that can be used after reporting such information. By taking this approach, the FRB further shortened and simplified the model form for this one time notice requirement.

With most FACT Act provisions becoming effective on December 1, 2004, federal agencies face a significant challenge in their efforts to finalize the remaining rulemakings by this date. Although the agencies may have an understandable desire to ensure that their regulations are promulgated quickly, it is more important that the rules are written correctly. These new rules will impose significant compliance and operational costs on credit granting systems; as a result, it is essential that the agencies carefully identify and implement the intent of Congress in promulgating the FACT Act regulations, even if it requires more time for the agencies to do so.

On April 16, 2004, the FTC issued a proposed rule that would require any person under the FTC’s enforcement jurisdiction that maintains “consumer information,” defined as any record concerning an individual that is a consumer report or was derived from a consumer report, to take reasonable measures to protect against unauthorized access to, or use of, the information in connection with its disposal. Subsequently, the federal banking agencies and the National Credit Union Administration ("NCUA") issued proposed rules that would amend their respective information security guidelines, implementing section 501(b) of the Gramm-Leach-Bliley Act ("GLBA"), to require entities under the enforcement jurisdictions of these agencies to implement controls designed to ensure the proper disposal of both “consumer information” and “customer information” in a manner consistent with existing GLBA information security requirements. These proposed rules would allow entities to employ different standards based on the individual entity’s risk assessment and circumstances in order to ensure appropriate disposal of information.

On April 23, 2004, the federal banking agencies and the NCUA issued proposed rules that would provide exceptions, for those entities under each agency’s enforcement jurisdiction, to the FACT Act’s broad prohibition on creditors obtaining or using medical information for credit eligibility decisions. As a result, although all creditors would be prohibited from obtaining or using medical information in connection with credit eligibility decisions, only a limited group of creditors could rely on the proposed exceptions. In particular, given the narrow wording of the proposed exceptions, nonaffiliated business partners of banks would not be able to rely on the exceptions in connection with their efforts to arrange credit on behalf of banks; in other words, even in those situations where a bank may be able to consider medical information because of an exception, its business “partner,” the doctor, may not be able to supply the information because the same exception is not available to the doctor. As a result, these proposed rules could significantly impact the availability of medical services and products to consumers, particularly consumers that lack or have limited medical insurance. These agencies must ensure that their final rules do not disrupt legitimate uses of medical information necessary to provide important medical services and products to consumers.
On April 21, 2004, the FTC issued a proposed rule concerning a combination of FACT Act identity theft requirements. This proposed rule would define the term “identity theft” as a fraud committed or attempted using the identifying information of another person. By including “attempted” fraud within the definition, the proposed rule would both greatly expand the scope of the conduct that entities must take steps to prevent under the identity theft prevention provisions and also increase the number of consumers authorized to take advantage of the rights conferred upon identity theft victims. The additional costs of expanding the definition of identity theft beyond the traditional notion of opening an account or obtaining a loan in another person’s name, would far outweigh the benefits received by consumers who are not actually victims of identity theft, and who likely suffered no harm from the attempted, but unsuccessful, fraud.

On June 10, 2004, the FTC issued a proposed rule to implement the FACT Act affiliate marketing provision. This proposed rule would prohibit any entity under the FTC’s enforcement jurisdiction from using specified information received from an affiliate to make or send marketing solicitations to a consumer, unless the consumer has been provided notice and an opportunity to opt out and the consumer has not opted out. The proposed rule would incorporate the FACT Act exceptions into this proposed rule, including allowing an entity to make or send marketing solicitations to consumers with whom the entity has a pre-existing business relationship. The federal banking agencies, the NCUA and the Securities and Exchange Commission are expected to issue similar proposed rules in the near future. It is critically important that these agencies ensure that a financial institution is permitted to market affiliate products or services to the institution’s own customers, such as through statement stuffers, even if the institution uses information from its affiliates to select the customers to receive those statement stuffers.

Several additional rules that will significantly affect the duties of financial institutions under the FCRA are expected to be proposed in the near future. For example, the FRB and FTC will propose rules to implement the FACT Act risk-based pricing notice provision that requires a lender in connection with an application for, or provision of, credit on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of that lender’s consumers, based in whole or in part on a consumer report, to provide a notice to the consumer. It is important that this rule maximize the benefits of consumer education through the notice, while minimizing the costs and operational difficulties of providing the notice to consumers. The federal banking agencies, the FTC and the NCUA also will prescribe “red flag” guidelines that establish procedures for institutions to use to identify possible instances of identity theft. This rulewriting directive has a broad scope, thereby allowing the agencies to adopt rules relating to many issues that could require significant alterations to business practices. In addition, these agencies will propose rules concerning the duties of furnishers of information to CRAs, including proposing guidelines and regulations that would require financial institutions and other information furnishers to establish and maintain reasonable policies regarding the accuracy and integrity of information furnished to CRAs, and identifying the circumstances in which furnishers must directly reinvestigate consumer disputes regarding the accuracy of consumer report information.
ECOA/AUTO FINANCE CLASS ACTION LAWSUITS
by Stephen G. Harvey
Pepper Hamilton LLP

At the ABA Section of Business Law 2004 Spring Meeting in Seattle, the Consumer Litigation Subcommittee presented a program entitled “Fair Lending and Auto Finance: Is There a Case for Discrimination?” The speakers were Thomas M. Byrne of Sutherland Asbill & Brennan LLP; Peter N. Cubita of Weil, Gotshal & Manges LLP; Glenda Gill of Operation Push Automotive Project; Stephen G. Harvey of Pepper Hamilton LLP; Stuart Rossman of the National Consumer Law Center; and Nina Simon of AARP as moderator.

The program explored some of the issues raised by the numerous class action lawsuits alleging violations of the Equal Credit Opportunity Act (“ECOA”) that have been filed in federal court against banks and finance companies that engage in the business of indirect automobile finance, including General Motors Acceptance Corp., Nissan Motor Acceptance Corp., Toyota Motor Credit Company, Ford Motor Credit Company, DaimlerChrysler Services North America LLC, Bank One, Bank of America, PRIMUS, Wells Fargo, American Honda Finance Company, WFS Financial, Firstar, U.S. Bank, Union Acceptance Corporation, and Am South Bank.

The Plaintiffs’ Legal Theory

The legal theory advanced in each of the cases is identical. Borrowing concepts developed in the employment discrimination context under Title VII, the plaintiffs claim that the defendant has a policy of “authorizing” car dealers to “markup” an objective financing rate set by the bank or finance company and that statistical analysis will show, the plaintiffs claim, that the policy causes African Americans or Latinos to pay more “markup” than similarly situated whites. Thus, plaintiffs allege, even though the credit scoring system used by the banks and finance company is objective (i.e., non discriminatory), the alleged policy of authorizing dealers to make credit pricing decisions unintentionally results in discrimination.

The Factual Background

The subject of the ECOA class action lawsuits is indirect auto finance. The companies that engage in this business do not extend credit directly to consumers. Instead, they finance consumer purchases of cars indirectly through car dealers. Car dealers are independent businesses not owned or controlled by banks or finance companies. They sell cars for cash or credit. When they sell a car on credit, it is usually accomplished by entering into a retail installment sales contract with the consumer. The car dealer and the customer enter into the retail installment sales contract and agree on the annual percentage rate (“APR”).

Dealers sell their retail installment sales contracts to banks and finance companies. Banks and finance companies offer to buy retail installment sales contracts at a “buy rate.” They periodically publish their buy rates. If the buy rate is less than the APR, the difference is compensation to the dealer. This difference is known in the industry as “dealer reserve” or “dealer participation.” The plaintiffs in the ECOA lawsuits call it “markup.”
Most car dealers sell their contracts to multiple banks and finance companies. The banks and finance companies compete for the retail installment contracts by offering competitive buy rates.

**Defenses Raised in Lawsuits**

The panelists discussed some of the defenses that have been raised in lawsuits, including the following:

**No “Markup Policy.”**

The defendants in the ECOA class action lawsuits contend that if the plaintiffs are going to borrow from the Title VII cases, then they must prove the existence of the “markup policy” they claim exists with respect to each defendant. The defendants argue that the plaintiffs cannot meet this fundamental requirement because banks and finance companies do not “authorize” dealers to set the finance charge on retail installment contracts higher than the buy rates. The banks and finance companies also argue that they do not control car dealer pricing. They simply buy retail installment sales contracts from car dealers in a competitive secondary market and pay compensation to the dealers for the contracts. The banks and finance companies argue that, as a result, the facts of these lawsuits are not alike or analogous to the facts of the cases under Title VII upon which plaintiffs rely.

**Disparate Impact Does Not Apply.**

The defendants in these cases argue that disparate impact liability is not available under the ECOA or, at most, disparate impact under the ECOA applies only to determinations of creditworthiness.

**Not a “Creditor” Under ECOA.**

The ECOA applies only to “creditors.” See 15 U.S.C. §1691(a)(1); 12 C.F.R. § 202.4. The Federal Reserve Board has defined the term “creditor.” 12 C.F.R. § 202.2(l). Under the Board’s definition, for a bank or finance company that accepts the assignment of a retail installment contract to be a “creditor,” two conditions must be satisfied. First, it must have participated in a decision whether or not to extend credit. Second, it must have knowledge or other notice of an ECOA violation at the time it bought the contract.

The first condition will not be met anytime the underlying transaction between the car dealer and the customer was a spot delivery. In the typical spot delivery situation the dealer extends credit before ever seeking approval from a bank or finance company to purchase the contract. The second condition will not be met unless the bank or finance company “knew or had reasonable notice of the act, policy, or practice that constituted the violation before becoming involved in the credit transaction.” 12 C.F.R. § 202.2(l). The defendants contend that they could not have known of any ECOA violations because, among other things, they are prohibited by federal law from collecting information about the race of their customers and thus never know the race of their customers.

**No Standing.**

Defendants have argued that the plaintiffs in these cases have no standing under Article III of the United States Constitution because they cannot show that they were treated worse than
white customers of the car dealers with whom they entered into the retail installment contracts. The defendants argue that to demonstrate injury in fact, the plaintiffs must prove that they were treated worse than white customers of the dealer with whom they contracted. The plaintiffs claim that discrimination must be measured on a national level. They seek to compare the amount of dealer reserve on their retail installment contracts with the average amount of dealer reserve for all white customers nationwide over a period of more than ten years. The only court to consider this issue to date agreed with the defendants and dismissed the action for lack of standing. See Osborne v. Amsouth Bank, No. 3:02-CV-577, 2003 WL 22025067 (N.D. Tenn July 15, 2003).

No Disparate Impact.

None of the lawsuits have been tried on the merits. If any reach that stage, the defendants are sure to defend the lawsuits on the grounds that, even if the plaintiffs could prove the existence of the alleged “policy,” there is no proof that it causes a disparate impact.

Business Justification

If any of the lawsuits are ever tried on the merits, the defendants are likely to defend on the grounds of business justification. The business justification for paying dealers for retail installment contracts is competition. Any bank or finance company that did not pay dealer reserve would be forced to get out of the business, because no car dealers would sell its contracts.

Status of the Lawsuits

In several of the cases, the courts have denied class certification. In Rodriguez v. Ford Motor Credit Co., No. 01 C 8526, 2002 WL 655679, at *5 (N.D. Ill. Apr. 19, 2002), the court held that a class could not be certified under Fed. R. Civ. P. 23(b)(3) in such a case because “a trial would require an individualized inquiry into the reasons for thousands of credit decisions” and thus be unmanageable. The case was later dismissed. A federal judge in Indiana followed Rodriguez in denying class certification in two other cases raising the same claim. Wise v. Union Acceptance Corp., No. IP 02-0104-C-M/S (S.D. Ind. Oct. 5, 2002); Cortez v. Union Acceptance Corp., No. IP 02-0105-C-M/S (S.D. Ind. Oct. 5, 2002).


As noted previously, one court dismissed the plaintiffs’ claim outright for lack of standing. Osborne v. Amsouth Bank, No. 3:02-CV-577, 2003 WL 22025067 (N.D. Tenn. July 15, 2003). In cases against Toyota Motor Credit and Wells Fargo, motions to compel arbitration have been granted. The rest of the cases are pending.
On May 19, 2004, the Department of Justice settled a suit against Old Kent Financial Corporation and Old Kent Bank (“the Bank” or “Old Kent”) for alleged Fair Lending violations by “redlining” in its residential real estate and commercial lending in Michigan between 1996 and 2000. Old Kent has since been acquired by Fifth Third Bank, which was not named in the complaint. Under the terms of the settlement agreement, which must still be approved by the court, the Bank, which has denied any wrongdoing, will invest $3 million in a special financing program over the next three years, invest $200,000 in financial education, and open three new branches in Detroit.

The Justice Department’s complaint alleged that the Bank, while expanding its business throughout the Detroit area, engaged in a pattern of locating branches to serve predominantly white areas, and largely avoided predominantly African American neighborhoods. According to the complaint, by March 2000, Old Kent had opened 53 branches in the Detroit metropolitan area but none in the City of Detroit, where the majority of the population was African American.

The Justice Department further alleged that, during the years in question, the Bank funded very few loans, either small business or residential real estate related, to residents of the City of Detroit, and that the Bank did not solicit applications from within the City of Detroit to the same degree as from other census tracts. The complaint noted that the Bank’s Community Reinvestment Act assessment area excluded the City of Detroit.

According to the complaint, the “totality of the [Bank’s] policies and practices…constitute the redlining of African American neighborhoods of the Detroit MSA.” The Justice Department charged the Bank with violations of the Fair Housing Act and the Equal Credit Opportunity Act (“ECOA”).

In its response, as set forth in the settlement agreement, the Bank stated that it did aggressively seek out business throughout the Detroit MSA, but found its efforts stymied by several factors. As a new entrant in the market, Old Kent grew by acquiring smaller community banks, which were largely located outside the City of Detroit. In the small business arena, the Bank argued that its effort to generate volume was hampered by the lack of a significant banking center presence in the City of Detroit. In residential lending, the Bank contended that the lending activity of its wholly-owned mortgage lending subsidiary—which accounted for nearly 80 percent of Old Kent Financial Corporation’s lending in the City of Detroit, was not taken into account.

The action is the most recent of several cases brought by the Justice Department’s Civil Rights Division over the past decade alleging redlining in residential real estate lending and demonstrates an ongoing interest in the application of evidence drawn from lending and branch distribution. It may be more notable, however, as the first complaint to extend the argument to the commercial lending side of the business.
DIDMCA PREEMPTION REVISITED IN ILLINOIS CASE
by John L. Ropiequet
Arnstein & Lehr LLP

A recent decision of the Illinois Appellate Court, First District, U.S. Bank N.A. v. Clark, 2004 Ill. App. Lexis 335 (Mar. 31, 2004), pet. for leave to appeal filed, No. 98379 (May 5, 2004), has created turmoil for mortgage lenders who do business in Illinois. The court held that a 1992 amendment to a provision of the Illinois Interest Act overrode preemption of interest and points caps under Section 501(a)(1) of DIDMCA. Thus, a 3-point cap on points for all mortgage loans with interest rates over 8% dating back to 1974, which lenders thought was a dead letter because of DIDMCA preemption in 1980 and a 1981 amendment to the Interest Act, was held to be fully applicable to all mortgage loans issued in Illinois after the effective date of the 1992 amendment. Absent reversal by the Illinois Supreme Court, this decision creates major problems for lenders which have existing Illinois loan portfolios or which issue new mortgage loans in Illinois.

DIDMCA preempted all state usury limits on first lien mortgage loans in 1980, unless states adopted legislation within a three-year period to opt out or unless they adopted new legislation to override the preemption. Illinois did not opt out, so DIDMCA preemption was considered to apply to first lien mortgage loans for Illinois borrowers.

The Illinois Interest Act had been amended prior to DIDMCA, in 1974, to put a 3% cap on points on what were then considered "high interest" mortgage loans, where the interest rate was in excess of 8%. Confusingly, the Illinois legislature amended another provision of the Interest Act in 1981, as market interest rates skyrocketed, to lift the limit on "any rate or amount of interest or compensation" for all mortgage loans. Despite the seeming inconsistency between the cap on points and lifting any limits on interest or "compensation," the legislature never reconciled these two provisions of the Interest Act.

The Seventh Circuit found that the 1981 amendment impliedly repealed the points cap in Currie v. Diamond Mortgage Corp. of Illinois, 859 F.2d 1538 (7th Cir. 1988). However, the Illinois Appellate Court took a different tack in 1991 in Fidelity Financial Services, Inc. v. Hicks, 574 N.E.2d 15, 214 Ill. App. 3d 398 (1991). The Illinois Department of Financial Institutions had issued an opinion letter following Currie, but the Hicks court found that there was no irreconcilable difference between the two provisions of the Interest Act since the points cap only addressed "ancillary charges" while the other provision regulated "the cost of money." Even though the case only involved a junior lien rather than a first lien, the court also found that DIDMCA preemption only applied to purchase money first liens, not to refinanced first liens.

Despite the Hicks ruling, subsequent federal district court cases and subsequent state agency interpretations continued to follow Currie. Accordingly, lenders believed that the 3-point cap on points was a nullity, having been preempted by DIDMCA and/or impliedly repealed by the Illinois legislature, and that the preemption applied to all types of first liens. The state agency interpretations, including a 1996 Illinois Attorney General opinion, were important because the penalty provision of the Illinois Interest Act provides a "safe harbor" for those who reasonably rely on agency interpretations, even if the courts later invalidate them.
The Clark Ruling

Clark was the result of a trial court decision in a number of consolidated mortgage foreclosure cases where borrowers had filed affirmative defenses or counterclaims claiming that their mortgages violated the points cap and entitled them to penalties under the Interest Act. Violations of the Interest Act allow the borrower to recover twice the total of all interest and points under the loan, plus attorneys fees, as a credit against future payments or as damages.

The stakes therefore were high when the chancery judge issued an opinion finding that the statements in Hicks were dicta and not to be followed. The court also rejected the argument that a 1992 amendment to the section of the Interest Act which contained the points cap operated to override DIDMCA preemption. The amendment added two subsections to the provision without changing any other language. The court found that the points cap could not be "considered as repealed and again enacted." Therefore, the amendment did not demonstrate the requisite legislative intention to override DIDMCA preemption.

The appellate court found that its earlier statements in Hicks were "judicial dicta," rather than "obiter dicta," which the trial court should have considered binding. Nevertheless, it based its decision on the changed circumstances created by the 1992 amendment to the Interest Act. In particular, it found that as of the date of the amendment, the legislature was charged with knowledge of the disagreement between the Currie and the Hicks decisions as well as DIDMCA preemption, so that its reenactment of the points cap in the amendment had to be considered as indicating an intention to override DIDMCA preemption.

The court also considered whether Parity Act preemption applied for alternative mortgage transactions. It found no conflict between the points cap and OTS regulation of alternative mortgage transactions. Accordingly, the Parity Act also did not preempt the points cap.

Impact On The Industry

There continues to be a wide divergence between state and federal interpretations of the Illinois Interest Act. The most recent federal district court decision on the subject, Spann v. Community Bank of Northern Virginia 2004 U.S. Dist. Lexis 5148 (N.D. Ill. Mar. 30, 2004), decided just one day before Clark, noted the disagreement between Hicks and Currie, but found that it was bound by Currie. For good measure, it also found that Hicks was "not binding evidence of state law in circumstances when it is not a good predictor of what the state's highest court would do in a similar case." Thus, whether a lender is sued in state or federal court will continue to be outcome-determinative. Class actions are already being filed in state court on claims that the points cap has been violated.

The Clark court did not address a number of questions that the parties briefed, including whether the 1981 amendment to the Interest Act impliedly repealed the points cap in the 1974 amendment. The court did observe in a footnote that lenders may qualify for the Interest Act's safe harbor if they relied on the 1996 Attorney General opinion or interpretations by other state
agencies. Of note is the fact that the Illinois Attorney General intervened on behalf of the borrowers and took a legal position contrary to the 1996 opinion, which has not been withdrawn or modified.

Lenders face some difficult decisions with respect to both their existing loan portfolios and new loans. If the appellate court's decision in Clark is upheld without significant modification, any Illinois mortgage loan which has an interest rate above 8% and more than 3 points could well be found to violate the Illinois Interest Act and subject any holder of the loan to significant penalties. There is little case law to give guidance as to the circumstances under which lenders can take advantage of the safe harbor as a complete defense to Interest Act liability, how to exercise the cure provision of the Interest Act to comply with the points cap, or whether a cure is even possible.

The defendant lenders have filed a petition for leave to appeal Clark to the Illinois Supreme Court, and the appellate court's decision is not final while it is on appeal. But there is no guaranty that the supreme court will accept the appeal and reverse, so lenders will have to consider carefully how to handle both existing loans and new loans from this point forward.
PREEMPTION AND FEDERALISM UPDATE  
by Jonathan D. Jaffe, Kirkpatrick & Lockhart LLP  
and Michael C. Tomkies, Dreher Langer & Tomkies LLP

Things have been busy on the preemption and federalism front since the Office of the Comptroller of the Currency (OCC) issued two long-awaited final rules on national bank preemption and visitorial powers on January 7, 2004. The first rule clarified what types of state laws apply to national banks, while the second clarified issues related to the OCC’s exclusive visitorial powers over national banks. Both rules took effect February 12, 2004. 69 Fed. Reg. 1895 (visitorial powers); 69 Fed. Reg. 1904 (preemption). In response to the rule, Congress has held hearings in both the Senate and the House, and the House passed an amendment expressing concern over the scope of the rules. The courts have already begun to issue decisions on previously filed actions that may indicate the general direction of judicial thinking on the rules. New actions have been filed challenging the OCC’s authority and a variety of decisions continue to outline the implications of preemption authority for state and national banks in various areas.

Web links to items discussed in this update and other preemption and federalism-related materials can be found on the Joint Preemption Task Force web page sponsored by the Consumer Financial Services Committee and the Banking Law Committee.

I. The OCC Rules

As we have been discussing with guest speakers and panelists representing a variety of interested parties from industry, state and federal regulatory agencies, the Conference of State Bank Supervisors and consumer advocacy groups, the preemption rule specifies the types of state laws that do not apply to national banks’ lending and deposit activities and the types of state laws that generally do apply to national banks. The lists of types of state laws that are not preempted in the final rule are substantively the same as in the proposed rule that we discussed last year. The final rule states that except where made applicable by Federal law, state laws that “obstruct, impair or condition” a national bank’s exercise of its lending, deposit-taking or other federal powers do not apply to national banks. The OCC has asserted that the final rule does not entail any new powers for national banks or any expansion of national banks’ existing powers and simply seeks to capture the preemption standards articulated by the United States Supreme Court. The final rule does contain new provisions prohibiting the making of any type of consumer loan based predominantly on the bank’s realization of the foreclosure value of the borrower’s collateral without regard to the borrower’s ability to repay the loan. The final rule also adds a new provision that explicitly prohibits a national bank from engaging in practices that are unfair and deceptive under the Federal Trade Commission Act. Finally, the OCC stated that based on existing regulations, the final rule would apply to operating subsidiaries.

The final visitorial powers rule is substantively the same as the proposed version of the rule with certain modifications. The rule clarifies the scope of the OCC’s exclusive visitorial authority over national banks in regard to activities authorized under federal law. The rule also clarifies the exception to the OCC’s exclusive visitorial power vested in the courts of justice. In its comments, the OCC stated that the final rule is consistent with federal law and the dual
banking system. In a chart comparing the scope of national bank, thrift and credit union preemption, the OCC indicated substantially the same scope as for thrifts.

As we have discussed in subcommittee meetings and programs, the final rules have generated strong verbal reaction. See, e.g., Release of New York Attorney General Eliot Spitzer: Statement by the Conference of State Bank Supervisors (CSBS); Statement by the National Conference of State Legislatures; Statement by Oklahoma Bank Commissioner; Congressional letter from Representatives Sue Kelly, Peter King, Carolyn Maloney and Carolyn McCarthy; Statement by Connecticut Attorney General Richard Blumenthal; Statement by the American Land Title Association, among others.

II. Congress Expresses Concern

Both House and Senate members have expressed concern regarding the OCC’s new rules. The House Committee on Financial Services actually voted 34 to 28 in favor of an amendment to the Committee’s Budget Views and Estimates for Fiscal Year 2005 expressing concern that the OCC will be forced to divert funds to consumer law enforcement efforts that typically have been undertaken by the states, thereby weakening its ability to carry out its primary mission of ensuring the safety and soundness of the national banking system. They compared the OCC’s staffing to the number of full time examiners and attorneys available to the states, noting that in 2003 state bank supervisory agencies initiated 20,332 investigations in the area of abusive mortgage lending alone, resulting in 4,035 enforcement actions. According to the amendment, the OCC’s rules “may represent an unprecedented expansion of federal preemption authority and a significant expansion of OCC’s regulatory responsibilities to monitor and enforce consumer law compliance.” Finally, the amendment observed that the OCC’s expansion of authority comes “without congressional authorization, and without a corresponding increase in budget resources.”

Both the House and Senate banking committees have held hearings at which Comptroller of the Currency John D. Hawke, Jr. gave testimony and various groups expressed both criticism and support of the OCC’s actions. In opening the House hearing on April 1, 2004, Chairman Michael G. Oxley stated that, in his view, the OCC has taken several constructive steps since the final rules became effective to address legitimate concerns expressed by House members and witnesses at prior hearings. Chairman Oxley noted that on March 1, the OCC issued guidance to national banks stating the OCC’s expectation that when national banks or their operating subsidiaries receive customer complaints forwarded by state authorities, they must take appropriate measures to resolve those complaints fairly and expeditiously.\(^{1}\) Chairman Oxley also referred to the fact that the OCC published a proposed rule that will result in a full listing of all national bank operating subsidiaries being available to the public over the Internet, to facilitate the processing of consumer complaints against such entities.\(^{2}\) The chairman applauded

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\(^{1}\) OCC Advisory Letter 2004-2. See [http://www.occ.treas.gov/ftp/advisory/2004-2.doc](http://www.occ.treas.gov/ftp/advisory/2004-2.doc). AL 2004-2 provides that national banks should seek to resolve consumer complaints fairly and expeditiously, regardless of the source of the complaint. The OCC does not regard referral by state regulators of complaints for resolution by a bank as a “visitation.” Thus, there is no need for banks to notify the OCC when a bank receives a referral of a routine consumer complaint from a state regulator. AL 2004-2 advises that a bank should inform the OCC if a state attempts to exercise visitatorial authority over a national bank or if a state referred complaint deals with the applicability of state law or preemption and encourages state officials to bring to the attention of the OCC any complaints that a national bank is engaging in illegal, predatory or unfair or deceptive practices so that the OCC can take the appropriate steps.

\(^{2}\) The proposed rule would require national banks to file an annual report with the OCC containing information about national bank operating subsidiaries that are not functionally regulated by other regulators and that do business directly with consumers. See 69 Fed. Reg. 15260. The OCC will make this information available to the public on its Internet customer service website at [www.occ.treas.gov/customer.htm](http://www.occ.treas.gov/customer.htm).
the OCC for taking these important steps and encouraged the OCC to continue to reach out to its state counterparts to address areas of common concern.

III. Court Decision Cites New OCC Rule In Finding Preemption

In what may be the first preemption decision rendered since the new OCC rules became effective, the United States District Court for the Northern District of Ohio found that the National Bank Act and corresponding federal regulations preempted a portion of the Ohio Retail Installment Sales Act (RISA). Abel v. KeyBank USA, N.A. 313 F. Supp. 2d 720 (N.D. Ohio 2004). The plaintiffs claimed a violation of Ohio’s holder in due course rule, which is codified as part of the Ohio RISA.

The court considered the case law on preemption, including the preemptive effect of regulations, and concluded that the National Bank Act and the corresponding federal regulations preempt the RISA, finding that the RISA provision significantly interferes with a national bank’s ability to negotiate promissory notes and lend money. The court cited 12 C.F.R. § 7.4008(d)(2)(iv) of the OCC preemption rule providing that state law limitations concerning the terms of credit, including the schedule for repayment of principal and interest, amortization of loans, balance, payments due, minimum payments or term of maturity of the loan, including the circumstances under which a loan may be called due and payable upon the passage of time or a specified event external to the loan are preempted as support for finding that the RISA is preempted.

The court concluded that the RISA more than “incidentally” affects the lending activities of national banks and thus rejected the plaintiffs’ position that the RISA was a state law that applied to national banks. The court also rejected the plaintiffs’ argument that the RISA was not preempted because it was a consumer protection statute, citing to the OCC testimony on the new OCC preemption regulations before the Subcommittee on Oversight and Investigations of the Committee on Financial Services of the U.S. House of Representatives on January 28, 2004. The court interpreted that testimony, which directly addressed state consumer protection statutes, to indicate at least in a general sense the federal government’s intent to preempt state consumer protection laws by enacting the revisions to the federal regulations. This case suggests that courts may be willing to give the OCC preemption rule, as well as OCC statements of intent, a high degree of deference.

IV. National Bank Operating Subsidiaries

In what appears to be the first ruling involving the OCC’s visitorial powers rule, the United States District Court for the District of Connecticut has concluded that if a state regulation interferes with a national bank’s operation of the business of banking through an operating subsidiary, a power which national banks are authorized to exercise, then that state regulation is preempted. See Wachovia Bank, N.A. v. Burke No. CIV.A. 303CV0738JCH (D. Ct., May 25, 2004).

Wachovia filed suit in April of 2003 challenging Connecticut’s authority to license and supervise Wachovia Mortgage Corporation, a wholly-owned operating subsidiary of Wachovia Bank, N.A. Wachovia claimed that federal law preempts the authority of state officials to

3 The rule permits a buyer to assert defenses against a holder of a purchase money loan installment note and to assert these defenses as affirmative claims. See Ohio Rev. Code § 1317.032.
regulate the operating subsidiaries of national banks. Thirty-five state attorneys general, supported by 43 state bank commissioners, filed an amicus brief in support of Connecticut Banking Commissioner John P. Burke. In granting Wachovia’s motion for summary judgment, the court agreed with Wachovia’s conflict preemption analysis, holding that 12 C.F.R. § 7.4006, the OCC’s rule on operating subsidiaries, is a reasonable interpretation of the National Bank Act, entitling plaintiffs to a declaratory judgment that the Commissioner cannot enforce the Connecticut state laws in issue against Wachovia Bank’s operating subsidiary, Wachovia Mortgage Corporation, in connection with the subsidiary’s mortgage lending business. The OCC's determination, that state regulation of operating subsidiaries to a greater extent than regulation of national banks themselves would potentially hinder the bank's "incidental" power, granted by regulation and implicitly acknowledged by statute, to conduct its banking business through a subsidiary, is reasonable, the court wrote. The court also found it reasonable for the OCC to conclude that its “surveillance, as it applies to the activities here, should be exclusive and preemptive.” (Emphasis in the original.)


V. Other Developments

A. U.S. Supreme Court Declines to Review Maryland Governing Law Decision

The United States Supreme Court has denied the petition for certiorari in Chevy Chase Bank, F.S.B. v. Wells, 124 S. Ct. 1875 (2004). The Maryland Supreme Court found in Wells v. Chevy Chase Bank, 832 A.2d. 812, 377 F.S.B. Md. 197 (2003), cert. denied, 124 S. Ct. 1875 (2004), that a federal savings bank’s contractual undertakings are not preempted under 12 C.F.R. § 560.2. In Wells, credit cardholders sued the issuing bank for breach of a credit card agreement that expressly selected as its governing law Subtitle 9 of Title 12 of Maryland’s Commercial Law on the basis that fees were increased without the notice required by Subtitle 9. The Court remanded Wells so that the lower court could apply state law contract interpretation to determine the parties’ rights and obligations under the agreement.

Notably, the U.S. District Court for the Southern District of New York has recently concluded that a general choice of law clause is insufficient as a matter of law to incorporate by reference preempted state laws as the terms of a contract. Flagg v. Yonkers Sav. & Loan Ass’n, FA 307 F. Supp. 2d 565 (S.D.N.Y. 2004).

B. Payday Lending Cases

The U.S. District Court for the Northern District of New York has granted New York Attorney General Eliot Spitzer’s motion to remand in New York v. County Bank of Rehoboth Beach, No. 1:03-CV-1320 (N.D.N.Y. May 25, 2004). Spitzer sued County Bank, a
Delaware-chartered bank, and two Pennsylvania-based companies, Cashnet, Inc. and TC Services Corporation d/b/a Telecash, in New York state court in October 2003, alleging that the defendants Cashnet and Telecash violated numerous provisions of New York law by making short-term “payday loans” to New York residents and that County Bank violated New York law in aiding and supporting their illegal efforts. According to the complaint, County Bank was the creditor on the payday loans in name only because Cashnet and Telecash, among other things, provided the capital to market, advertise, originate, service and collect the payday loans. Cashnet and Telecash also allegedly paid County Bank an annual fee to use the bank’s name and charter to make loans, paid the bank a percentage of the finance charge received on each loan, and agreed to indemnify the bank for losses and liabilities (other than credit losses) arising out of the loan operation.

C. Alternative Mortgage Transactions

In Glukowsky v. Equity One, Inc, 2004 WL 1159735 (N.J. May 26, 2004), the New Jersey Supreme Court held that the prohibition against prepayment penalties under the New Jersey Prepayment Law (NJPL) was preempted by former Office of Thrift Supervision regulations, which gave state-chartered housing lenders power to charge prepayment penalties in alternative mortgage transactions (AMTs). The plaintiff obtained a “balloon” mortgage loan from Equity One, Inc., which loan qualified as an AMT under the Alternative Mortgage Transaction Parity Act of 1982, 12 U.S.C. §§ 3801 et seq. (Parity Act). When the plaintiff subsequently sold the property securing the loan, Equity One exercised its right under the loan contract to demand full payment and impose a prepayment penalty. The plaintiff filed suit against Equity One, claiming that imposing such a fee violated, among other things, the NJPL. The lender filed a motion to dismiss, arguing that OTS regulations preempt any state law, including the NJPL, that prohibits a state-chartered lending institution from charging a prepayment penalty on an AMT. At the time of suit and prior to its amendment in 2002, Section 560.220 of the OTS regulations had extended Section 560.34 of the OTS regulations, which permits federally-chartered housing lenders to impose prepayment penalties, to state-chartered housing lenders.
In the world of lobbying nothing is more challenging than an election year. With the early resolution of the presidential primaries, the parties have started what passes for political discourse today. You know, the Democrats are all godless libertines and the Republicans, after a long day of reading the bond tables in Barron’s, relax by shooting orphans from their verandahs. As for Ralph Nader-- oh well, I can’t even think of anything to match his alternative reality.

Meanwhile, on Capitol Hill, in both the House Financial Services and Senate Banking Committees, consumer financial services legislation has been on the back burner—especially after last year’s passage of the FACT Act. Earlier this year most of the attention focused on legislation dealing with oversight of housing-related government sponsored entities (such as Freddie Mac, Fannie Mae and the regional home loan banks), however, this has now stalled in the Senate.

Because of this, Congress has turned its attention to two other, more-structural, issues: “Regulatory Relief” and FDIC Reform. In the case of Regulatory Relief, most of the provisions under consideration come from the federal banking agencies and the Conference of State Bank Supervisors (the professional society of state bank commissioners), hence it has been described by some on the Hill as “Regulators’ Relief”.

While the House passed Regulatory Relief legislation (H.R. 1375) by a wide margin in March, the Senate is now beginning the hearing and drafting process. This effort is being spearheaded by Idaho Republican Senator Mike Crapo who is attempting to craft legislation that focuses on industry-to-agency relationships while avoiding the internecine struggles that pit banks versus credit unions, small banks versus industrial loan companies and all of the usual old wounds that are reopened when comprehensive legislation is born (financial services legislation makes the Hundred Year’s War look like a walk in the park). H.R. 1375 also contained a number of credit union-related provisions which are, of course, reflexively opposed by banking trade groups.

In the case of FDIC reform, the major sticking point has been the insistence of trade associations representing small banks that any FDIC bill immediately increase the current level of deposit insurance from $100,000—an article of faith for their members. Congress has been active in its oversight role conducting hearings on a wide range of issues with much attention naturally focused on the Comptroller’s Rules on National Bank Preemption and Visitorial powers (although, in another chilling example of the “new normal”, the Senate hearing was postponed because of the ricin scare).

In the consumer financial services arena, on March 30, the House Financial Institutions and Housing Subcommittees held a joint hearing on subprime lending and, in particular, trying to define the subprime customer and the subprime market. Even Committees not necessarily known for involvement in the financial services world have looked into consumer credit related
issues. The Senate Permanent Subcommittee on Investigations held a hearing on abuses in the credit counseling field. The hearing focused a number of large counseling operations that, unlike the traditional services, seem to be thinly disguised for profit companies which over promise results to consumers. The Committee, which does not have legislative authority, recommended that some of the counseling services lose their tax exempt status.

Looking ahead, it is likely that oversight will continue as the Senate Banking Committee begins to review the effects of the Gramm-Leach-Bliley Act and there is talk about a House examination of risk-based pricing in the credit card industry. Meanwhile, that hardy perennial, bankruptcy reform languishes for yet another year.