Message from the Chair

The Consumer Financial Services Committee has been very busy since I issued my last Chair's report in the March 2005 CFSC eNewsletter, and we will present interesting meetings and programs at the ABA Annual Meeting August 6-8 in Chicago. As always, if there is anything that any member of the CFSC leadership group can do to enhance your membership experience, please do not hesitate to contact me.

2005 Annual Meeting in Chicago

Please join fellow CFSC members and others at the ABA Annual Meeting in Chicago. The CFSC will meet from Saturday, August 6 at 8:30 a.m. through Monday, August 8 at 12:30 p.m. [Click Here for the Consumer Financial Services Meeting Schedule] All CFSC meetings and programs will be held at the Westin Michigan Avenue Hotel. Thanks to the efforts and generosity of CFSC member John Ropiequet and his Chicago firm, Armstein & Lehr, LLP, we will enjoy the Committee Dinner and entertainment at Fulton's on the River, not far from the Westin at 315 N. LaSalle Street, on Saturday, August 6 at 7:30 p.m. In addition, there will be a Committee Reception in the Buckingham Room at the Westin on Friday, August 5, from 5:30 to 7:30 p.m., due to the generosity of CFSC member Richard Gottlieb and his firm, Dykema Gossett, PLLC. If you have not yet done so, you will be able to register for the Annual Meeting and, to the extent that seats are available, purchase Committee Dinner tickets on-site.

In addition to socializing and entertainment, our meeting's schedule includes two programs and the CFS Committee Forum on the following hot topics:

- Information Security and Dealing with Security Breaches
- Is the Price Right? Interpreting the New HMDA Data
- The Quid for the Quo: The Consumer Protection Provisions of the Bankruptcy Bill (Committee Forum)

Moreover, we will have our usual coverage of recent developments and new trends, as 11 of our 13 substantive subcommittees (all except Privacy and Housing Finance and RESPA, which have planned our two programs) will hold meetings. You will not want to miss these programs and meetings during this period of rapid change in consumer financial services law. I look forward to seeing as many of you as possible in my hometown, Chicago, the greatest city in America.

CFSC Winter 2006 Meeting in Park City

Anyone who attended the CFSC Winter 2005 Meeting in Key Biscayne, Florida this past January knows that the less-structured agenda and opportunities for informal discussion, socializing and recreation at our Winter Meetings cannot be topped! That these meetings are very enjoyable and stimulating is evidenced by the record turnout of 170 attendees at the Key Biscayne meeting. As is our custom, we return every other year to a ski-resort location. From January 7 to 10, 2006, we will meet at the Park City Marriott
Hotel in downtown Park City, Utah, near restaurants and shops and close to skiing and other winter recreation. This meeting, unlike our usual Winter Meeting schedule, will begin on a Saturday night, January 7, with a Welcome Reception generously sponsored by Tom Billings and his Salt Lake City-based firm, Van Cott, Bagley, Cornwall & McCarthy, which will commence around 6:30 p.m. The meeting will end on Tuesday, January 10 at around 11:00 a.m. Fewer than the usual number of rooms that have been reserved for the Winter Meetings will be available at the Marriott, but some additional rooms will be available at the Yarrow Resort Hotel. You will want to reserve a hotel room promptly once you receive meeting information, which should be sent and posted on the CFSC website in early to mid-October.

Membership Matters

The CFSC continues to seek to increase membership and meeting attendance and participation by and among minority and in-house lawyers. All CFSC members, but especially minority and in-house lawyers, are encouraged to contact Membership Subcommittee Chair Julie Caggiano (713-357-3647; Julie.Caggiano@AegisMtg.com) or Vice Chair Joe Looney (410-865-5436; jlooney@hudco.com) to volunteer to speak or help plan programs and meeting sessions, write articles for the Annual Survey of Consumer Financial Services Law that appears in The Business Lawyer, the CFSC eNewsletter, Business Law Today and other ABA or Business Law Section publications, and help plan Committee Dinners and Receptions and other social and recreational events.

In addition, we have an active mentoring program in which any CFSC member can obtain a mentor in a particular substantive CFS law area or on other matters, such as taking advantage of attendance at ABA, Section and Committee meetings and earning leadership opportunities. We are looking for mentors as well as mentees. Please contact Julie or Joe for more information or to volunteer to be a mentor.

Projects

I want to commend to you John Ropiequet’s excellent summary later in this issue on the Committee’s extensive pro bono activities. There will be reports on other CFSC projects in the next eNewsletter.

Allard Glass Cutter Award

It is a pleasure to announce that my immediate predecessor as CFSC Chair, Lynne Barr, received the 2005 Jean Allard Glass Cutter Award at the Spring Business Law Section Luncheon in Nashville. The Award recognizes a woman member of the Section who has achieved professional excellence in her field, demonstrated dedication to the work of the Section and has been actively involved in the mentoring of, and served as a role model for, other women members of the Section. Lynne richly deserves the Award, and I am sure that you all join me in congratulating her on this honor.

Programs
There are two upcoming ABA CLE programs that I recommend to CFSC members. First, CFSC member and Liaison to the Business Law Section Diversity Committee Elizabeth Yen has organized and is speaking at a live teleconference and audio webcast entitled "Avoiding Enforceability Issues in Consumer Contracts" on August 10, 2005 from 1:00 to 2:00 p.m. EDT. http://www.abanet.org/cle/programs/b05ace1.html  Second, thanks to the efforts of Immediate Past CFSC Chair Lynne Barr, she and several other long-time Committee leaders and CFS law experts (Roland Brandell, Rick Fischer and Robin Warren) will present the consumer financial services law component of the National Institute on Banking Law II, which will be held at ABA headquarters in Chicago on September 29-30, 2005. The CFSC and the Banking Law Committee have developed the program agenda and are furnishing the speakers. This course is designed to build on the successful Banking Law Basics course and to provide practitioners with exposure to a broader range, and more detailed analysis of certain key aspects, of the regulatory structure governing banks and bank holding companies. http://www.abanet.org/cle/programs/n05bla1.pdf

Leadership Changes

I will send an e-mail to the Committee Listserve by the end of July 2005 detailing changes in the CFSC leadership that will take effect at the end of the Annual Meeting. I look forward to sharing this exciting news with you. (I have one year remaining in my term as Chair, so you will be hearing from me in several more eNewsletters!) If you are interested in learning about the qualifications and duties of a Subcommittee Chair or Vice Chair, please contact me or one of my very able Vice Chairs, Margie Corwin (410-576-4041; mcorwin@gflaw.com) and Don Lampe (336-574-8057; dlampe@wcsr.com).

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

Latest Updates

Washington Update
Frank Salinger

In his Washington Update, Frank Salinger, Vice President of Government Regulations for Advanta Corporation, provides a review of Washington developments, by reviewing congressional accomplishments to date on legislation in the area of consumer financial services.

More...

FACTA Update
Patricia Covington

New regulations regarding handling of consumer information, privacy of medical information, and commercial use of consumer
credit reports are explained by Patricia Covington's FACTA Update.

More...

Pro Bono Update
John Ropiequet
Read John Ropiequet's update to find out about pro bono initiatives the Consumer Financial Services Committee accomplished this past year, and what plans are in store for the year to come.

More...

Featured Articles

The 2005 CFSC Spring Meeting was on March 31-April 3. Below are some programs that you should not have missed!

The Life Story of a Prepaid Card Program
Roberta Torian
This Program provides an overview of a recent panel discussion where leading minds in the areas of Consumer Financial Services and Cyberspace law debated the emerging challenges and legal issues facing prepaid card programs.

More...

Consumer Debt Elimination Schemes and Scams
Eric Mogilnicki, Kelly Cochran
Trends in novel schemes and scams to eliminate consumer debt are addressed in Consumer Debt Elimination Schemes and Scams, which reviews a forum discussion between panelists from the FBI and FDIC.

More...

Bankruptcy Act Amends Truth-in-Lending Act
Timothy P. Meredith, Catherine M. Brennan
Timothy P. Meredith and Catherine M. Brennan, of Hudson Cook, LLP, provide insight into how recent amendments to the Bankruptcy Code also amend the Truth in Lending Act.

More...
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Considering this column is going to press the week Congress returns from the July 4th recess (or, for those of you not focused on the congressional calendar, Major League Baseball’s All-Star break), it seems to be a good time to review what has been accomplished in the area of consumer financial services-related legislation so far this year.

While most legislation that interests readers comes out of the House Financial Services or Senate Banking Committees (think of them as the American and National Leagues to run the baseball analogy into the ground), this year, the most significant legislative accomplishment comes from the fractious world of the judiciary committees: bankruptcy reform. Here is a review of the key issues:

**Bankruptcy Reform.** After an eight year legislative struggle, President Bush signed S. 256, the *Bankruptcy Abuse & Consumer Protection Act*. The centerpiece of the legislation -- and the most controversial provision -- establishes an objective needs-based bankruptcy test for determining whether a consumer debtor is eligible for Chapter 7 relief.

The Act also makes a number of substantive changes to consumer credit disclosures. These include:

- New disclosures of minimum payments; introductory rates; late payment deadlines; penalties for open-end lines of credit; and the tax consequences of certain home equity loans.
- Additional information about minimum payments must be available via a toll-free telephone number.
- Requiring internet-based credit card solicitations to include specified Truth in Lending Act disclosures.
- Prohibiting closing an open-end consumer loan account solely because the borrower has not incurred finance charges.

The Act also requires the Federal Reserve to conduct studies regarding information available to potential borrowers from consumer lenders regarding factors qualifying borrowers for credit, repayment requirements, and the consequences of default; the adequacy of consumer protections to limit liability from unauthorized use of a debit card; and the impact of credit extended to dependent college students.

The politics around passage of this bill has led to a hearing on credit card marketing practices. Arguably, this is the price paid for a number of senators dropping proposed amendments.
Credit Card Hearings. On May 17th, the Senate Banking Committee held a hearing on credit card pricing, disclosures and other practices. Although not called to address specific legislative proposals, a wide range of issuer practices were sharply criticized by consumer advocates and some senators. These include:

- Authorization of credit putting customers over their limit
- Debit card fee disclosures
- Foreign currency conversion charges
- Introductory rate “teaser” disclosures
- Length of grace periods
- Minimum payment disclosures
- Negative amortization of credit card payments
- Payment cut-off times (credit for timely payment)
- Risk-based pricing
- Marketing to students and other minors

Although the hearing was an oversight hearing, Senators Akaka (D-HI) and Feinstein (D-CA) testified in support of bills they had previously introduced to restrict many of these practices. Senator Dodd (D-CT) has introduced a more comprehensive bill, S. 499, the Credit Card Accountability Responsibility and Disclosure (CARD) Act, which would limit a number of these practices.

Currently, no action has been scheduled on these bills.

Several senators asked the agency witnesses, Federal Reserve Board Governor Gramlich and OCC General Counsel Julie Williams, if the banking agencies had both sufficient authority to deal with credit card issues and reliable information about rates and industry practices. Williams recommended that the OCC be given the additional authority to define “unfair and deceptive practices,” which is authority currently reserved to the FTC.

Ms. Williams’ testimony also emphasized the OCC’s efforts to test the effectiveness of disclosures via focus groups of actual consumers. A number of the witnesses (and some senators) suggested that consumer disclosures should eventually be more like the nutritional labels found on food products (i.e. easy to understand and following a clear format).

Credit card issues are not merely within the relevant financial committees. For example, universal default provisions became the subject of a House Appropriations Committee vote which approved an amendment to prohibit card issuers from using negative information in a customer’s credit report to raise rates unless the information involves the customer’s card account.

As you can guess from its name, the Appropriations Committee funds federal agencies including, in this instance, the Department of the Treasury. Appropriations strategies (the legislative equivalent of a Hail Mary) are not that unusual. The amendment was stricken
on the floor of the House for procedural reasons (appropriations bills are generally not supposed to include substantive legislative proposals).

Another issue, presently in the courts, is that of interchange fees which are paid by merchant-acquiring banks to cardholder-issuing banks to cover the cost to convert a charge on a cardholder’s card to a cash deposit at the merchant’s checking account. It also defrays costs such as billing services, credit and fraud risk, and profits.

Interchange may become a legislative issue if retail trade associations (the litigants against card associations) are able to get oversight hearings in either the judiciary committees, the House Financial Services, or Senate Banking Committees.

These are not the only credit card-related issues. Many other, more generic issues, such as data security and the accuracy of credit reporting agency data (and the accuracy of reinvestigations of such data) impact consumer credit as well.

**Data Security.** The recent data breach of credit card accounts at CardSystems Solutions, a payment processor, is another example of continuing well-publicized events leading Congress toward legislation in this area. There are a number of bills in various stages of the drafting process taking different approaches to deal with data breaches.

The inherent problem drafters face is devising a framework that deals with institutions and processors already regulated (by laws ranging from the FACT Act to Gramm-Leach-Bliley) while also addressing concerns about unregulated data warehouses and processors.

This dichotomy is also reflected by the differences in Congressional committee jurisdiction. Thus, whatever may finally emerge from the banking-related committees will differ from the work product of the judiciary committees. Because this area is still fluid, the next edition of this column will spell out proposals in more detail.

**High Cost Mortgage “Predatory Lending.”** The House Financial Institutions and Housing Subcommittees held a hearing on May 24th regarding two bills designed to curb predatory mortgage lending practices. One bill, H.R. 1295, the Responsible Lending Act, sponsored by Representatives Ney (R-OH) and Kanjorski (D-PA) is generally supported by industry; the other, H.R. 1182, the Prohibit Predatory Lending Act, sponsored by Representatives Miller (D-NC) and Watt (D-NC) has the support of consumer advocates. The bills are very different, the former provides for a federal preemptive regulatory scheme, while the latter relies on state and local laws.

The mark-up process (the mechanism wherein a committee considers amendments and prepares a bill for eventual passage) may begin before the August recess, but is more likely to occur after Labor Day.

The Senate has not yet acted.
**Pay-day Lending.** Although regulated by state laws, pay-day loans *(called cash advance or salary advance loans by that industry)* have become the subject of growing interest on Capitol Hill, particularly, since FDIC-insured institutions have exported rates into states with restrictive laws. [For a detailed outline about the regulation of this industry, see Richard Eckman’s article, *Is Pay-day Lending Paving the Preemption Path?*, in the last edition of this newsletter]

While a number of bills have been introduced in both Houses without any action, legislation to restrict pay-day loans to military personnel has moved forward.

On June 28, 2005, the House passed H.R. 458, the *Military Personnel Financial Services Protection Act* which, although principally drafted to ban the sale of contractual mutual funds on military bases, also restricts pay-day loans to military personnel. The bill bans requiring the involuntary assignment of military wages to secure payment of a loan; contacting, or threatening to contact the borrower’s commanding officer in an effort to collect a loan; and, requiring the borrower to waive their rights under the Servicemembers Civil Relief Act.

Additionally, certain high cost loans must be accompanied by a disclosure notice outlining these protections as well as describing other credit options including grants or interest free loans from the military relief societies in the case of a family or other emergency.

A similar bill *(which only dealt with contractual mutual funds and did not address pay-day lending)* passed the House in the last Congress but failed to move in the Senate.

**Other Legislative Issues.** While not directly related to consumer credit, both the House Financial Services Committee and the Senate Banking Committee have held hearings and passed legislation on a wide variety of issues ranging from GSE reform to USA PATRIOT Act reauthorization to regulatory relief.

**Oversight Issues.** Although not necessarily leading to legislation, the Congressional oversight function should not be minimized. For those seeking insight into future legislative trends and to see what industry and consumer advocates alike view as top priorities, reviewing testimony is a valuable source. That testimony is available on-line at the committee’s web site. In addition to the issues discussed above, some consumer credit-related issues which have also been the subject of hearings include:

- Access to credit for underserved consumers
- Identity theft
- Promoting competition in the real estate services market
- Securities arbitration
- Zero down payment loans

* * *
This periodic *eNewsletter* is designed to give a broad overview of consumer credit-related issues. More detailed information may be found on the web sites of the House Financial Services and Senate Banking Committees.

Most of the national financial trade associations and consumer advocacy organizations have comprehensive, although naturally specialized, reporting on their web sites and many provide much of their non-confidential content to the non-member browser.
FACTA Update
By Patricia Covington
Hudson Cook, LLP

A fair bit has occurred on the FACTA front. First, the Disposal Rule went into affect both for FTC regulated businesses, as well as for entities regulated by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration and the Securities and Exchange Commission.

The FTC’s Disposal Rule was issued on November 18, 2004, and took effect June 1, 2005. The banking regulators, NCUA and SEC’s Disposal Rule was issued on December 28, 2004, and took effect on July 1, 2005. The Disposal Rule mandates the proper disposal of consumer information, or any compilation of consumer information, by taking “reasonable measures to protect against its unauthorized access to or use of this information in connection with its disposal.” Under the FTC’s rule “consumer information” is defined as “any record about an individual whether in paper, electronic, or other form, that is a consumer report or is derived from a consumer report.” Under the banking and regulatory agencies’ rule “consumer information” is defined as “any record about an individual, whether in paper, electronic, or other form that is a consumer report or is derived from a consumer report and that is maintained or otherwise possessed by or on behalf of the institution for a business purpose.” Under the banking regulators’ rule, banks have until July 1, 2006 to modify their contracts with service providers to ensure contractor compliance with the rule. A Business Alert was issued by the FTC explaining to businesses how to comply with the new Disposal Rule and is available at http://www.ftc.gov/bcp/conline/pubs/alerts/disposalalrt.pdf.

On June 6, 2005, the banking regulators and the NCUA issued interim final rules regarding the privacy of medical information under Section 411 of FACTA. The Medical Privacy Rule was published in the Federal Register on June 10, 2005 (70 Fed. Reg. 33958, 6/10/05). The rule takes effect in nine months, and though the rules are final, the banking agencies and NCUA accepted comments for 30 days. Section 411 of FACTA amends the FCRA to add a new section which prohibits creditors from obtaining or using medical information in connection with credit eligibility decisions. A second provision was added which limits the ability of affiliates to share medical information. Consumer reporting agencies (“CRAs”) are also prohibited from furnishing medical information in connection with a credit transaction but for certain exceptions. CRAs may furnish medical information where the information “is reported using codes that do not identify … the specific [medical] provider or the nature of such [medical] services.” Further, medical information may be furnished by CRAs where the information is relevant to process or effect the credit transaction and the consumer gives specific written consent to the reporting of this information. Under § 411, the banking agencies and NCUA were directed to create exceptions to the new limitations as “necessary and appropriate to protect legitimate operational, transactional, risk, consumer, and other needs.”
The regulators first proposed a rule in April 2004. There was widespread reaction to the rule because the proposed exceptions would only apply to a few class of creditors. Nonbank finance companies, state-chartered credit union, motor vehicle dealers and others would not have been eligible for the exceptions. After receiving numerous comment letters identifying this problem, including one by the FTC, the Federal Reserve Board clarified in its final rule that the exceptions are available to all creditors. The final rule also specifies when and how affiliates may share medically related information. Several examples were included to explain the exception. A copy of the interim final rules may be obtained at:


On August 1, 2005, the FTC’s Prescreen Opt-Out Disclosure rule becomes effective. Section 615(d) of the Fair Credit Reporting Act (“FCRA”) requires that any person who uses a consumer report to make an unsolicited firm offer of credit or insurance to a consumer, provide with the solicitation a clear and conspicuous statement with the disclosures identified in the section. FACTA amended § 615(d) of FCRA to require that the disclosure of § 615(d) “be presented in such format and in such type size and manner as to be simple and easy to understand as established by the Commission, by rule, in consultation with the Federal banking agencies and the National Credit Union Administration.”

The final rule issued by the FTC requires a two part notice, with both parts emphasizing the consumer’s right to opt out of future prescreened solicitations. The “short form” notice must be on the front page of a paper solicitation or on the first web page in close proximity to the principal marketing message, and must be distinguished “from other text, such as inside a border.” The type style must also be “distinct from the principal type style used on the same page, such as bolded, italicized, underlined and/or in a color that contrasts with the color of the principal text on the page.” Further, it must be in a type size larger than the type size of the main text of the solicitation, but in no event, less than 12 points.

The long form notice must begin with the heading “PRESCREEN & OPT-OUT NOTICE,” which must be in all caps and underlined. Similar to the short form, the type style must be distinct. The type size must be the same size of the text on the same page, but no less than 8 point type. In response to comments, the final rule makes several adjustments to the requirements. It clarifies that the short form notice must accompany the “principal promotional message”—“the document designed to be seen first by the consumer, such as a cover letter” in a paper solicitation, or in an electronic message, on the same web page but not necessarily the same screen as the “principal marketing message.” Also, the language of the long form notice makes more clear that the consumer should contact the consumer reporting agencies, not the creditor or insurer, to opt out.

Finally, rulemaking still must occur and may be published as early as this fall on the establishment of “red flag” guidelines for the identification of identity theft, regulations for credit card and debit card issuers regarding the investigation of address
changes, guidelines for furnishers of credit information for the enhancement of the integrity and accuracy of data reported to CRAs, and the identification of circumstances under which furnishers must reinvestigate a dispute.
In connection with the Business Law Section’s pro bono initiative, A Business Commitment, announced in 2004, the Consumer Financial Services Committee chose to promote financial literacy as its pro bono effort. The CFS Committee achieved the following last year:

- Created a list of committee members who have volunteered to participate in pro bono work, as opportunities arise in the future.

- Under the leadership of David Melcer, Nathan Bowden and Terry Franzen, the Committee’s Safeborrowing.com website was enhanced by integrating it with other related and useful websites which offer additional financial education to consumers.

- Through Michael Sullivan’s initiative, the Committee participated in a Pennsylvania Department of Banking study on foreclosure rates.

In 2005, CFS Committee pro bono volunteers have:

- Under the leadership of Dan Tyson, cosponsored a workshop held in Austin, Texas, at the Business Law Equal Justice Conference this past May, on combating predatory foreclosure practices.

- Under the direction of Rhonda Daniels, a panel of volunteers was assembled to act as a speakers bureau to make financial literacy presentations in their local areas around the country, and to answer inquiries to the “contact us” link on our website.

- Trish Obara coordinated an effort to establish reciprocal links on Safeborrowing.com to other websites.

- Finally, Charles Pearce spear-headed an effort to add auto financing content to Safeborrowing.com.

The pro bono volunteer group is also considering additional enhancements to Safeborrowing.com which would allow users to download financial literacy materials. It also plans to coordinate volunteer opportunities with the federal Financial Literacy and Education Commission’s future initiatives.

The volunteer group is eager to take advantage of additional opportunities as they develop. Contact Pro Bono Liaison John Ropiequet by e-mail at jropiequet@arnstein.com or call him at (312) 876-7814 if you would like to participate in any of the items listed above or if you have any thoughts about additional actions that can be taken by the pro bono volunteers on the CFS Committee.
The Life Story of a Prepaid Card Program
By Roberta Torian
PNC Bank

During the 2005 Business Law Section Spring Meeting in Nashville, the Committee on Consumer Financial Services and the Committee on Cyberspace Law presented a joint forum on “The Life Story of a Prepaid Card Program.” The illustrious panel consisted of Barry Abbot of Howard, Rice, Nemerovski, Canandy, Falk & Rabkin, Jeffrey Felser, Senior Vice President for PNC Bank, Pittsburgh, Pennsylvania, Daniel G. Lonergan, an attorney with the Federal Reserve Board in Washington, D.C., Scott Scovill with American Express Travel Related Services and Judith Rinearson of Katten Muchin Zavis Rosenman in New York. The moderators were Richard Hackett of Pierce Atwood, chair of the Internet Services Electronic Banking Subcommittee and Robert Ledig of Fried, Frank, Harris, Shriver & Jacobson, chair of the Committee on Cyberspace Law.

The lively discussion dissected two (2) prepaid card programs, one was the payroll card and the other was the gift card. The panel was unique in that it included astute business observations regarding the factors evaluated in determining what type of card to issue, pricing, target market, what features are most likely to win favor in the market, as well as how to handle compliance issues from a business perspective without making the product cumbersome and unattractive. The legal and regulatory perspective was quite broad and addressed Regulation E, deposit insurance, anti-money laundering, the Patriot Act and escheat issues as well as the seldom addressed topic of the wind down and termination of a card program.

The first type of prepaid card program addressed was that of a branded card to be issued by a bank for use by employers for payroll. The card could be loaded only by the employer, would have ATM and point of sale purchasing capabilities, and permit the issuance of a second access card to a third party, including someone located outside of the United States. The card could be co-branded with a payroll company such as ADP.

The second type of prepaid card program discussed was the open system gift card program. In this program, a bank or a non-bank that has a payment network, such as American Express, can be the issuer. These cards can be purchased in various denominations and used by merchants that honor the issuer’s cards. Like American Express however, these cards cannot be used at ATMs. The cards can be co-branded, for instance with a mall, such as the Simon gift card, or a membership group, such as AAA. The co-sponsors market the cards to their own members or customers.

The life cycle of the cards was divided into three (3) segments, initial planning, design and launch; problem solving and managing change for ongoing programs; and the wind down and termination of a card program.

Business issues included: identifying the target customer; what functions the card should perform; which entity (e.g. issuer or customer) will issue, market and process or service the card; how will the cards be distributed; structural issues; licenses; the economics of
the product; whether the cards are reloadable; fees (which can be a significant issue under state law); who will own and secure the cardholder data; applicability of the Bank Secrecy Act and Patriot Act requirements; and finally, what disclosures need to be given and when they need to be given. Felser’s model is to treat payroll cards as if they are subject to Reg E, and the Patriot Act.

A discussion was held regarding the issues surrounding reloadable cards. There are many companies that seek to have cards that can be remotely reloaded, which means that the cardholder may go to a merchant, such as a convenience store, hand cash to the merchant and the merchant will load the cash onto the card. Needless to say this methodology raises issues regarding money laundering and therefore, remotely reloadable cards must be carefully structured and closely scrutinized. With respect to payroll cards, additional questions were raised as to whether the imposition of overdraft fees which are deducted from the next payroll load constitute garnishment of wages.

With respect to customer identification issues and regulatory applicability, the panel was in general agreement that gift cards issuance and maintenance are much less circumscribed than payroll cards at the federal level, however, as with payroll cards, they would be subject to state laws.

Charges and fees are a significant issue for payroll cards and gift cards. Because the unbanked are a target market for payroll cards, they must be priced in a way that allows the potential employee cardholder to view them as competitive with, or preferable to using a check casher. In addition, the gift cards are subject to laws enacted at the state level regarding how quickly inactivity charges may become effective, expiration dates and other fees that will negatively impact the balance on the gift card. Both cards are arguably subject to escheat laws of the various states which can be a deterrent to issuing the cards.

Disclosures for payroll cards in most instances are similar to disclosures for debit cards issued to bank customers and are distributed with the card. On the other hand, open system gift card disclosures are, on occasion, printed on the card itself. This is because gift cards typically have fewer rules, such as expiration dates, the amount and commencement date of inactivity fees. In most instances, lost or stolen gift cards are not replaceable therefore, the error resolution procedures which are applicable to a payroll card are generally not applicable to a gift card which significantly decreases the disclosures provided. An additional factor is the ability of prepaid cardholders to know their balance. Ideally, merchants would be able to provide this information at point of sale however, very few merchants have terminals that are capable of providing a balance; the terminals merely communicate with the data base which indicates whether or not there are sufficient funds remaining on the card to cover the transaction at hand. By contrast, payroll cards have an advantage in that they can be used at ATMs which in the overwhelming majority of instances can provide a balance. Gift cards, which cannot be used at ATMs, do not offer this advantage.
The course materials included charts on state laws affecting prepaid cards, particularly, state abandoned property laws. In many states the property laws limit expiration dates, service and dormancy fees and some prohibit all fees for prepaid cards. Alternatively, some states’ abandoned property laws explicitly state that they are applicable only to gift certificates or explicitly exclude prepaid cards. Money transmittal laws are applicable to gift cards such as those issued by American Express. The chart provided listed states that have money transmittal laws that explicitly address prepaid cards.

The panel discussed the issue of pre-emption, citing the *Massachusetts vs. Simon Property Group* case, which challenged the Simon gift card. Additional regulatory matters addressed were the proposed amendment to the FDI Act (which is now being revised). For example, under Regulation D, would issuers be required to reserve against deposits and prepaid cards; under Regulation CC, must purchases and payments be subject to the funds availability rules; does Regulation DD provide that these cards are accounts, and if so, does the Truth in Savings rules apply. Also left unresolved is whether or not a retail outlet becomes a branch because it sells bank cards.

Daniel Lonergan of the Federal Reserve Board discussed the proposed amendment to Regulation E’s commentary to include payroll cards as subject to Regulation E. As of the date of this article, the Fed does not anticipate having a final rule published by the end of the third quarter 2005.

As the audience response clearly indicated, this panel was highly informative and entertaining.
Consumer Debt Elimination Schemes and Scams
By Eric Mogilnicki and Kelly Cochran
Wilmer Cutler Pickering Hale & Dorr LLP

A Committee Forum chaired by Marjorie Corwin of Gordon, Feinblatt, Rothman, Hoffberger & Hollander, LLC and Eric Mogilnicki of Wilmer Cutler Pickering Hale and Dorr, LLP recently discussed current consumer “debt elimination” schemes that purport to challenge the validity of customer loans. Panelists from the FBI and FDIC, as well as in-house and outside counsel, reported that debt elimination scams are proliferating via the internet. In return for fees ranging from $3,000 to $20,000, debt elimination websites offer to help consumers challenge the validity of their loans.

Examples of such schemes included:

- Sham “arbitrators” that state that a debt is invalid and/or that lenders owe the consumers money for engaging in unlawful conduct;
- Claims similar to those raised by the Freemen and other “constitutionalist” groups in the 1990s, asserting that loans are invalid unless they are paid out in gold, or that loan assignments have violated the borrowers’ trademark and copyright interests in their own names;
- Offers by borrowers to exchange their notes and deeds of trust for “bonds” or other bogus assignments of interest, followed by the assertion that lenders who fail to respond or who attempt to reject or dispute the tender have accepted the offers; and
- Attempts by borrowers to convince title insurance companies to record false Reconveyances of Deeds of Trust or tenders of bogus payoff checks that may prompt lenders to record reconveyances themselves. If bona fide purchasers or bona fide encumbrancers subsequently get involved with the same property, they may be deemed to have superior interests to the original lenders.

Mark Malovos of New Century Mortgage Corporation of Irvine, California described the challenges these type of schemes pose for in-house counsel. Although these debt challenges can seem ludicrous, he and the other panelists warned that it is critical for financial institutions to respond promptly to customer communications, since they may constitute qualified written requests under the Real Estate Settlement Procedures Act, debt validation or cessation letters under the Fair Debt Collection Practices Act, or rescission efforts under the Truth in Lending Act. Borrowers or debt elimination promoters will often send their initial challenges to corporate headquarters, so it is important that such correspondence be forwarded to the proper department promptly. Malovos’ company assigns every debt elimination communication a tracking number for follow-up and has developed a series of letters that it sends out to explain to why these challenged loans are in fact enforceable.

Another expert on these practices, Stuart B. Wolfe of Wolfe & Wyman, LLP, in Irvine, California, warned that it is important to use a firm but respectful tone in such
communications, since regulators do not like to see consumer communications treated dismissively. He and Malovos reported that as many as 60% of debt challenges are dropped after the borrowers receive a few letters from their lenders explaining why particular debt elimination theories are invalid. Both believe that this pattern demonstrates that many of the customers suspect going in that the debt elimination schemes are too good to be true. Eric Mogilnicki added that once consumers realize that they have been duped by bogus arbitration schemes, some are willing to work with lenders to shut down “debt elimination” websites. Other consumers, however, will continue to challenge their loans as invalid in hopes of recovering the money that they have paid to participate in the debt elimination programs.

H. Andrea Gribble of the FDIC Financial Crimes Group recommended training tellers to watch carefully for bogus payoff checks—which often appear facially correct but lack watermarks or are printed on the wrong kind of paper—and responding promptly to customer challenges to avoid litigation. Since debt elimination participants who attempt to file legal challenges often appear pro se, she noted that the courts will often grant them extra latitude.

FBI Supervisory Special Agent John Coliano reported that his agency and many states Attorneys General have stepped up enforcement efforts against debt elimination schemes. While it is relatively easy to convince web server providers to shut down bogus sites, Coliano explained that it can take a great deal of time and effort to build cases against particular companies.

Coliano noted that Federal Reserve Board SR Letter 04-3 directs regulated lenders to submit Suspicious Activity Reports (“SARS”) concerning debt elimination schemes. Last year, approximately 1500 of the roughly 17,000 SARS filed referenced debt elimination. Coliano encouraged financial institutions to contact law enforcement personnel directly about such activity and to supplement SAR filings if they notice that similar patterns involving additional loans.
On April 14, 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “Act”). The Act was signed by President Bush and became law on April 20, 2005.

While the bill makes substantial changes to the current bankruptcy law, it also makes numerous amendments to the Truth in Lending Act ("TILA"). Those changes affect both open and closed end disclosure rules. Creditors will have a reasonable period of time to comply with the changes. As a general rule, you will have a period of at least one year after the Federal Reserve Board ("FRB") publishes regulations to implement the new provisions.

The new law will affect the following disclosures.

• **Credit and Charge Card Application and Solicitation Disclosures**
  o New introductory rate disclosures.
  o New rules on use of the Schumer Box disclosures in connection with Internet solicitations.

• **Billing Statements**
  o You must disclose the amount of and due date for any late charge.
  o You must include a model warning (that includes payment examples) showing the customer how long it will take to repay the balance if the customer makes only the minimum payment.

• **Limitation on Your Right to Terminate an Account**
  o You may not close an open end account simply because the account no longer accrues finance charges.

• **Credit Secured by the Consumer’s Principal Dwelling (open or closed end)**
  o New application disclosures:
    • You must warn the customer that interest may not be deductible on the portion of a loan or line that exceeds the fair market value of the property.
  o New advertisement disclosures
• You must warn the customer that interest may not be deductible on the portion of a loan or line that exceeds the fair market value of the property.

• You must instruct the consumer to consult a tax advisor for further information on the deductibility of interest and charges.

• The Meaning of “Clear and Conspicuous”

  o The Act requires the FRB (along with the FTC and the other banking regulators) to develop guidance on the meaning of the general disclosure standard of “clear and conspicuous.”

CREDIT CARD APPLICATION AND SOLICITATION DISCLOSURES

**New introductory rate disclosures.** If you offer a credit card that includes a discounted or low introductory rate, you must add the following to the application or solicitation disclosures and all the related promotional materials that accompany the application or solicitation:

(i) Use the term “introductory” in immediate proximity to each listing of the temporary annual percentage rate;

(ii) If the rate that will apply after the end of the temporary rate period will be a fixed rate, you must state in a clear and conspicuous manner in a prominent location closely proximate to the first listing of the temporary annual percentage rate (other than a listing of the temporary annual percentage rate in the Schumer Box), the time period for the introductory rate period and the annual percentage rate that will apply after the end of the introductory period; and

(iii) If the rate that will apply after the end of the temporary rate period will vary in accordance with an index, you must state in a clear and conspicuous manner in a prominent location closely proximate to the first listing of the temporary annual percentage rate (other than a listing in the Schumer Box), the time period for the introductory rate period and the rate that will apply after that, based on an annual percentage rate that was in effect within 60 days before the date of mailing the application or solicitation.

You do not have to add the additional rate information to the envelope or other enclosure in which an application or solicitation to open a credit card account is mailed.

If you can increase the introductory rate under any circumstance or upon any event before its term expires, you must add the following to the application or solicitation:

(i) A general description of the circumstances that will allow you to increase the introductory rate; and
(ii) The following information about the rate that will go into effect when you revoke the introductory rate:

(I) If that rate will be a fixed rate, you must disclose the annual percentage rate that will apply when you revoke the introductory rate; or

(II) If that rate will vary in accordance with an index, you must disclose the rate that will apply after the temporary rate, based on an annual percentage rate that was in effect within 60 days before the date you mailed the application or solicitation.

**The Schumer Box and the Internet.** If the solicitation appears on the Internet or other interactive computer service, you must disclose the information currently required to be disclosed under TILA § 127(c)(1)(A) and (B) (the “Schumer Box” information) in addition to the information regarding introductory rates. The electronic disclosures must be:

(i) Readily accessible to consumers in close proximity to the solicitation to open a credit card account; and

(ii) Updated regularly to reflect the current policies, terms, and fee amounts applicable to the credit card account.

**OPEN-END CREDIT PERIODIC BILLING STATEMENTS**

**New late fee disclosures.** If a late payment fee will be imposed for a billing cycle, you must add the following information to the billing statement:

(i) The date on which the minimum payment is due or, if different, the earliest date on which a late payment fee may be charged; and

(ii) The amount of the late payment fee to be imposed if payment is made after such date.

**Minimum payment disclosures.** You must add a disclosure to the front of the periodic billing statement that explains the impact of making only the minimum monthly payment. (These requirements do not apply to any charge card account, the primary purpose of which is to require payment of charges in full each month.)

If you maintain a toll-free telephone number for the purpose of providing customers with the actual number of months that it will take to repay the customer’s outstanding balance, you must include the following information on the front page of the billing statement:

Making only the minimum payment will increase the interest you pay and the time it takes to repay your balance. For more information, call this toll-free number: XXXX.

If you do not maintain a toll free number for this purpose, then the content of the notice will differ based on the identity of your regulator for TILA purposes. If the FTC is your TILA
regulator, you must provide the following statement, in a prominent location on the front of the billing statement:

Minimum Payment Warning: Making only the required minimum payment will increase the interest you pay and the time it takes to repay your balance. For example, making only the typical 5% minimum monthly payment on a balance of $300 at an interest rate of 17% would take 24 months to repay the balance in full. For an estimate of the time it would take to repay your balance, making only minimum monthly payments, call the Federal Trade Commission at this toll-free number: XXXXXX.

If the FTC is not your TILA regulator, you must provide one of the following disclosures on the front page of the billing statement:

(i) If the minimum monthly payment on the plan is not more than 4% of the balance on which finance charges are accruing:

Minimum Payment Warning: Making only the minimum payment will increase the interest you pay and the time it takes to repay your balance. For example, making only the typical 2% minimum monthly payment on a balance of $1,000 at an interest rate of 17% would take 88 months to repay the balance in full. For an estimate of the time it would take to repay your balance, making only minimum payments, call this toll-free number: XXXXXX.

(ii) If the minimum monthly payment on the plan is more than 4% of the balance on which finance charges are accruing:

Minimum Payment Warning: Making only the required minimum payment will increase the interest you pay and the time it takes to repay your balance. Making a typical 5% minimum monthly payment on a balance of $300 at an interest rate of 17% would take 24 months to repay the balance in full. For an estimate of the time it would take to repay your balance, making only minimum monthly payments, call this toll-free number: XXXXXX.

In complying with the above requirements, you may substitute an example based on an interest rate that is greater than 17%. Any creditor that is subject to the FTC’s jurisdictions may elect to provide the more specific disclosures required for all creditors not subject the FTC’s jurisdiction.

OPEN-END CREDIT GENERALLY

You may not terminate an open end consumer credit plan (of any type) prior to its expiration date solely because the consumer has not incurred finance charges on the account. This does not prevent you from terminating an account for inactivity in 3 or more consecutive months.

CREDIT SECURED BY THE BORROWER’S PRINCIPAL DWELLING
Currently, TILA requires you to instruct HELOC applicants to consult a tax adviser regarding the deductibility of interest and charges. The Act requires you to provide that disclosure in connection with closed end loans as well.

The Act also requires you to give specific tax advice in connection with high loan to value loans (again, for both open and closed end transactions that are secured by the consumer’s principal dwelling). Specifically, if the consumer applies for a loan where the principal amount or credit limit exceeds the fair market value of the dwelling (as defined under the Internal Revenue Code of 1986), you must inform the consumer that the interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes.

Finally, any advertisement for a high LTV loan disseminated in paper form to the public or through the Internet must state that:

(i) The interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes; and

(ii) The consumer should consult a tax adviser for further information regarding the deductibility of interest and charges.

THE MEANING OF “CLEAR AND CONSPICUOUS”

Not later than six months after the enactment of the Act, the FRB must consult with the other Federal banking agencies, the National Credit Union Administration Board, and the Federal Trade Commission, and promulgate regulations to provide guidance regarding the meaning of the term “clear and conspicuous.” The FRB must ensure that the clear and conspicuous standard will result in disclosures that are reasonably understandable and designed to call attention to the nature and significance of the information disclosed.