News from the Chair
by Donald C. Lam
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Greetings from the Consumer Financial Services Committee. We mark this year as the 40th Anniversary of the Committee. It is an honor to serve as your Chair during this significant time, and with that there is the pleasure of organizing special events throughout the year to celebrate our history and success.

First, let me thank our Publications Subcommittee, Rick Eckman, Chair, and David Beam, Vice Chair, for spearheading our e-newsletters. CFSC Member Stephanie Cohen aided them in the course of preparing reports from our Winter Meeting in Dana Point, California, in early January. Speaking of which, we saw record attendance at the Winter Meeting, held January 6-9, 2007 at the Laguna Cliffs Marriott, with over 225 registered Members. We enjoyed seeing old friends and making new ones. The presentations and programs were outstanding, and our dinners and recreational events were not to be missed.(All of the hikers who ventured into the Laguna Hills (led by Margie Corwin) returned to the hotel accounted for, but we are not sure the "whale watching" crew ever got back to the Dana Point marina.) Our Golf Tournament at the stunningly beautiful seaside course, Monarch Beach Golf Links, was a highlight, and our thanks go out to Mike Wippler of Dykema Gossett for his superb organizational effort and his Firms’ generous financial contribution to the event.

Our Committee is not just about our regularly-scheduled meetings. We seek to better serve our 900+ Members, and periodic e-newsletters are part of that effort. In 2007 and during the remainder of my term as Chair, leadership of the Committee will remain focused on reaching out to Members who are not able to attend our meetings. If you fit that category, recommendations on how we can better serve you are welcomed - please email me at dlampe@wcslr.com with any ideas or suggestions. Many of our activities, including pro bono, publications and task force participation, are open to Members who cannot regularly attend meetings.

We announce two significant developments as we kick off our anniversary year of 2007:

- Formation of a new Subcommittee, the Young Lawyers Subcommittee. This will be a Subcommittee consisting of lawyers who are 40 or under or have practiced consumer financial services law full time (or full time equivalent) for less than 10 years. We will send a follow up email message on this, but if you fit this category, and wish to be a "charter member" of this exciting new Subcommittee, please contact me via email at email address above. We will hold an informational meeting for this Subcommittee at the upcoming Spring Meeting (see below) but you need not be present to join.

- We will organize the In-House Counsel Roundtable, a special group within our Committee for in-house attorneys to confer and share ideas on matters of mutual interest. At the outset, we hope that numbers of our more senior in-house counsel Members will affiliate with the In-House Counsel Roundtable and encourage other attorneys on their legal staffs to join, as well. We likewise will follow up with further information on this initiative shortly.

Spring Section Meeting 2007

Our Spring Meeting, held in conjunction with the Business Law Section Annual Meeting, is around the corner. Our meetings will
be held March 15-17, 2007, at the Washington, DC Convention Center. Our offerings will include outstanding presentations from our Subcommittees, as well as programs on the Watters case and federal preemption, consumer authentication in the delivery of online financial services and state enforcement of consumer protection laws (in conjunction with The Conference on Consumer Finance Law). Most importantly, we will continue to mark the 40th Anniversary of the Committee with a special Forum, "The Consumer Financial Services Committee at 40," an extended program with a panel of eminent long-time Members, followed by a festive reception at Goodwin Procter’s nearby Washington, DC office. Information, including registration, programming and hotel reservations, may be found at: http://www.abanet.org/buslaw/meetings/2007/spring/registration.shtml#site Our Committee Dinner is to be held at the Capitol Club on Capitol Hill on Thursday, March 15 and requires separate registration and payment. If you have not registered for the Dinner already and need information, please contact Toyin Alaka at the Business Law Section: alaka@staff.abanet.org If you have not registered for our meetings yet, please do so now and we will see you soon in Washington, DC.

2007 American Bar Association Annual Meeting

As is ordinarily the case, we will hold Consumer Financial Services Committee meetings and programs at the ABA’s Annual Meeting, this year in San Francisco, CA. The Annual Meeting is being held August 9-14, 2007, but the exact times of our Committee meetings within the meeting dates are not yet set. Our meetings are to be held at The Fairmont Hotel. Early registration information is available at: http://www.abanet.org/annual/2007/. You are encouraged to book your hotel early, as ABA site hotels tend to sell out early.

We look forward to another great year of fellowship, education and service. We invite you to be a part of it.

Donald C. Lampe, Chair,
Consumer Financial Services Committee
ABA Section of Business Law

Updates

Truth in Lending Subcommittee - Case Summaries

The Truth in Lending Subcommittee summarized recent TILA cases. The following cases were specifically highlighted at the Winter Meeting.

HOEPA:
James v. New Century Mortgage Corp., 2006 WL 2989242 (E.D. La. Oct. 17, 2006). The court held that HOEPA only applies to secondary mortgages. However, the court ruled this way because the plaintiff failed to respond to defendant’s allegations. This holding—which is widely regarded as incorrect—should not be relied on.
Morris v. Novastar Mortgage Inc., 2006 WL 2707349 (W.D. Mo. Sept. 19, 2006). The court held that a judgment creditor obtained against borrower was to be considered a finance charge at closing of the refinancing of the loan, making the loan subject to HOEPA.

Rescission:
Palmer v. Champion Mortgage, 465 F.3d 24 (1st Cir. (Mass.) Sept. 29, 2006). The court held that a rescission notice form was accurate and valid even though it contained a deadline date that could have been confusing to consumer.

Handy v. Anchor Mortgage Corporation, 464 F.3d 760 (7th Cir. (Ill.) Sept. 29, 2006). The court held that a customer who received 2 separate rescission notices, one that followed the Reg. Z H-9 model form (for refinancing with the original creditor) and one that followed the Reg. Z H-8 model form (the general form, which is the appropriate form for refinancing with a new creditor), could not have known which was the correct one, and was thus entitled to a 3 year rescission period.

Damages:
In re Ferrell, 2006 WL 3298330 (9th Cir. BAP (Bankr. D. Nev.) October 27, 2006). The court held that a payday lender's actions did not subject it to damages.

More comprehensive summaries of these cases and summaries of other cases published from January 1, 2006 through December 31, 2006 can be found at: http://www.mavent.com/aba/TILACASESUMMARIES12-31-06.PDF.

Compliance Management and Privacy Subcommittee - Joint Session on Fair Credit Reporting Act and New Red Flag Guidelines

The Compliance Management and Privacy Subcommittees sponsored a joint session at the Winter Meeting on the recently released proposed Fair Credit Reporting Act Red Flag Guidelines. Betsy Broder of the Federal Trade Commission and David Stein of the Federal Reserve Board led the discussions.

On July 18, 2006, the Office of the Comptroller of the Currency, the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, and the Federal Trade Commission jointly issued proposed regulations that would provide guidance related to identity theft Red Flags and address discrepancies under the Fair and Accurate Credit Transaction Act of 2004. The agencies proposed guidelines for financial institutions and creditors identifying patterns, practices, and specific forms or activity, that indicate the possible existence of identity theft. The agencies also proposed regulations requiring each financial institution and creditor to establish reasonable policies and procedures for implementing the guidelines, including a provision requiring credit and debit card issuers assess the validity of a request for a change of address under certain circumstances. In addition, the agencies included guidance regarding reasonable procedures users of consumer credit reports must employ when such a user receives notice of address discrepancy from a consumer reporting agency. Comments were due on September 18, 2006. The final guidance has not been issued.

Mr. Stein summarized the proposal. Financial institutions and creditors would be required to establish a written, risk-based identity theft program designed to address the risk of identity theft to customers and the safety and soundness of the financial
institutions. The Red Flags the guidance requires financial institutions and creditors to focus on come from 4 sources: (1) Appendix J of the guidance; (2) regulatory guidance; (3) identity theft the institution itself has been a victim of in the past; and (4) other methods of identity theft the institution believes it could be a victim of. Institutions will be required to choose Red Flags they will adopt based on risk assessment they must conduct. Consumer groups have expressed great concern about giving institutions too much discretion when some situations are clearly always Red Flags.

The proposed requirements for the Red Flag programs include a process to detect a possible risk of identity theft, to verify identity of persons opening an account, to detect Red Flags identified, to assess whether detected Red Flag actually evidences risk of identity theft, to mitigate risk of identity theft, to train staff, to oversee service providers, and to receive board’s approval, oversight, management and reporting. Each program must be appropriate to the size, complexity and nature of the institution, and the scope of its activities. In addition, the program must be sufficiently flexible to address changing risks as they arise.

Debt Collection Practices and Bankruptcy Subcommittee - The Consumer Side of FDCPA: Emerging Litigation Theories and

The Debt Collection Practices and Bankruptcy Subcommittee's session at the Winter Meeting covered emerging litigation theories under and the legislative agenda for the FDCPA. The speakers were Cathleen M. Combs of Edelman Combs Lattimer & Goodwin LLC, and Robert J. Hobbs of the National Consumer Law Center.

Mr. Hobbs started his presentation by reporting that some of the major issues still being dealt with by residents of New Orleans, such as post traumatic stress syndrome, affected debt collection practices in the area.

The panelists also discussed abusive practices by debt buyers who purchase spreadsheets containing very little—and often incorrect—information about the accounts. Typically these spreadsheets contain only basic information about the debtor and the account, and no information as to past collection efforts, payment/settlement agreements or results of identity theft investigations. This, combined with the fact that debts are typically bought and sold several times and that debtors do not recognize the name of the current debt owner, often leads to communications with debtors that are at best confusing to the debtor, and at worse harassing. Legislative reform to deal with these issues is being encouraged.

Cathleen Combs also echoed the need for legislative reform of the FDCPA, pointing to the stated acceptable methods of communication as being outdated, and other provisions as requiring clarification, such as the definition of "net worth" which could be interpreted as the amount an account is sold for or the account balance.

Federal and State Trade Practices and Preemption and Federalism Subcommittees - Federalism from the Viewpoint of State Attorneys General

The Federal and State Trade Practices and Preemption and Federalism Subcommittees sponsored a joint session focusing on federalism from the viewpoint of State Attorneys General. The speakers were Michael S. Greve, John G. Searle Scholar and Director of the AEI Federalism Project at the American Enterprise Institute, and Jerry Kilgore, former Attorney General of Virginia. The speakers led an animated discussion.
about recent efforts by state attorneys general to use their authority to seek reform in areas traditionally regulated by the federal government.

Dr. Greve introduced the topic by discussing the underlying causes of the trend toward more activist attorneys general. He started by noting that the trend is "like gravity"—it gets you down, but there is little that you can do about it. He then argued that activism by attorneys general was the result of several structural characteristics in American government. First, attorneys general enjoy considerable independence under most state constitutions, and have incentives to expand the power of their offices. Second, our federal structure allows state officials to act without the authorization of the federal government.

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Internet Delivery/Electronic Banking Subcommittee - Gift Cards and Other Hot Topics

The Internet Delivery/Electronic Banking Subcommittee's session at the Winter Meeting focused on prepaid cards. Obrea O. Poindexter of Morrison Foerster and Russell Schrader of Visa U.S.A. provided a comprehensive overview of the subject. The presentation covered: (1) an important recent case, (2) guidance on gift cards issued by the Office of the Comptroller of the Currency ("OCC"), (3) state laws regulating gift cards, and (4) the Department of Justice assessment of stored value cards and money laundering.

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Mr. Kilgore provided advice to business and their attorneys about how to deal with Attorney General investigations. When dealing with letters of inquiry, Mr. Kilgore suggests meeting with the Attorney General’s office early to discuss the scope of the inquiry. A timely response is critical, as a delayed response could raise suspicion. He also recommended that subjects of an investigation be proactive and follow up with the Attorney General’s office instead of waiting for them to decide the next step. Like letters of inquiry, cease and desist letters must be taken seriously. It is vital to open the lines of communications with the Attorney General’s office to determine the basis of the letter.

Mr. Kilgore also explained that subpoenas must be handled with great care. Companies receiving subpoenas for investigations for which they are not the target should take measure to ensure the company’s exposure is not increased. Companies must make sure they understand who is the target, the company's connection to the target, and the purpose of the investigation. If something in the requested information could be misinterpreted, it is vital that the Attorney General’s office fully understands the context of the materials.

When the company itself is the target, Mr. Kilgore recommended that it start by determining how public the subpoena is and develop an appropriate response strategy. The company should immediately stop email and document deletion. This is crucial for both public relations and relations with the Attorney General, since, whether or not destroyed documents in fact had pertinent information, the public and the Attorney General will assume it did. A meeting with the Attorney General or the agency should be set as soon as possible. This will give the company the opportunity to begin developing an effective approach to the subpoena. It is crucial to determine, very early on, whether in-house counsel or outside counsel should conduct the inquiry. Finally, implementing a
public relations plan, both internal and external, will help with the process of restoring trust in the company and in management.

Mr. Kilgore strongly suggested taking proactive steps in dealing with Attorneys General. Some of his suggestions included inviting the Attorney General’s team for a meeting to open the lines of communications before a problem arises, sponsoring consumer programs on initiatives that are important to the Attorney General, and performing ongoing or periodic audits. Mr. Kilgore also suggested that self reporting and immediate corrective actions are typically very effective.
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Gift cards do present money laundering concerns, however. While it is relatively easy for authorities to detect a suitcase filled with a large amount of cash, it is quite easy to smuggle one card that may hold a similar amount completely undetected. In order to counter this, new operating regulations will prohibit obtaining cash from cards.

In August 2006, the federal government issued a final rule now in effect, and requiring mandatory compliance by July 2007. This rule provides that Regulation E covers payroll card accounts—that is, prepaid cards used to pay employee salaries. The final rule applies to prepaid card accounts established directly or indirectly through an employer, and to which transfers of the consumer’s salary, wages, or other employee compensation made on a recurring basis. The rule does not apply to retailer gift cards provided to employees by employers as gifts, since those cards are not created by the employer. It also would not apply to cards on which a bonus is deposited, unless bonuses are paid in this manner on a regular/recurring basis. In addition, the final rule provides there is no need for a periodic statement for cards if the balance is available by a toll free number and a website, and if, upon request, the provider provides written history of transactions to the consumer.

Health spending-related cards are also excluded from the regulation. Regulators have clarified that a card benefits from this exemption even if it could be used for other purposes, as long as it is primarily used for health related spending.

In August 2006, the OCC, which is the primary regulator of national banks, issued guidance related to gift cards. While this guidance only applies to national banks, Mr. Schrader asserted it is a good basis for establishing best practices in the gift card industry. The guidance contained no preemption provisions, but seems to suggest co-branded cards would be covered by this guidance as well. The OCC provided that disclosures should have the name of the issuing bank, the fees, an indication of where the card can be used, a statement emphasizing the importance of tracking balances, an indication of whether split
tenders are permitted, and a statement regarding dispute resolution. In addition, the guidance suggests misleading and deceptive marketing efforts should be avoided.

Prepaid cards are also subject to state laws, including escheat laws, fee restrictions, and unfair or deceptive acts or trade practices laws. Many states also have laws that specifically regulate gift cards. For example, some states require that the expiration date for a gift card be disclosed, while other states prohibit expiration dates. In addition, while there has been much discussion recently about dormant fees, not much focus has been directed at whether initial or activation fees are permitted.

Many uncertainties continue to exist, including how to handle preemption of state prepaid card laws. The Office of Thrift Supervision (“OTS”), the primary regulator of federal savings associations, issued a legal opinion recently in which it concluded that the following types of state gift card laws were preempted for federal savings associations: licensing regulations, disclosure requirements, fee restrictions, expiration date restrictions, and requirements related to permitting card holder to redeem the cards for cash. The OCC, however, has not provided similar guidance for national banks.

Mr. Schrader also discussed the Simon Malls litigation. In November, 2004, 3 states sued Simon Malls. The main issue of contention was preemption. In New Hampshire, the state is appealing an order from the federal court holding that state laws were preempted for the program by federal law because the cards had been issued by a federally-chartered bank. In Massachusetts, there has been no action by the AG in the past year. In Connecticut, Simon Malls is appealing the denial of its claim that state laws cannot be applied to it because its partner in the gift card program was a federally-chartered bank. It should be noted that, since these lawsuits were filed, this program has undergone many changes.
Litigation and Arbitration Subcommittee
Report on RAND Institute for Civil Justice’s Study on Class Actions in the Insurance Industry

The Litigation and Arbitration Subcommittee’s session at the Winter Meeting focused on a study on class actions in the insurance industry published by the RAND Institute for Civil Justice. RANDS’ Nicholas M. Pace provided an insightful look at the study and its results.

The RAND study found that while the number of class action filings against insurers has been rising over the past 10 years, only a small fraction are being certified - about 14%. This is important because certification appears to be the key driver behind settlement. For all attempted class actions, a negotiated settlement binding on the entire class took place in only 12% of cases while individual settlements occurred in another 20%. Defendants were able to get nearly four out of ten cases dismissed. For class actions where a motion for certification was made, class settlement was much more likely, with a third of all cases resulting in class settlement (the individual settlement rate remained at 20%). For certified classes, nine of ten cases resulted in class settlement.

About three-fourths of the class actions appeared to be based, in whole or in part, on state UDAP laws, suggesting the state legislatures have the ability to influence both the frequency and character of class action litigation.

The fees and expenses of class counsel reported in the study ranged from $360,000 to $150,000,000, with a median fund size of $2,600,000. Median total payout was $500,000. Fees and expenses in reported cases ranged from $50,000 to $50,000,000 with a median award of $554,000. The fees and expense percentages ranged from 12 to 41% of the common fund, with a mean of 29% and median of 30%. But if the amount of money actually distributed to the class were used as the benchmark for calculating attorney compensation rather than the common fund theoretically available at the time of settlement approval, the median increases to 47 percent. In a quarter of settlements with available data, the “effective” fees and costs percentages were 75 percent or higher and in 14 percent, the effective percentages were over 90 percent.