Summary of August 10-14, 2007 Meeting

The Consumer Financial Services Committee - The Consumer Financial Services Committee at 40: Developments in the Practice and Thoughts on a Bright Future

The Consumer Financial Services Committee held a forum to mark the 40th Anniversary of the Committee. The panel consisted of former chairs of the Committee, who discussed events and initiatives that have significantly impacted the composition, topic coverage and growth of the Committee through the years. The speakers included Lynne Barr of Goodwin Procter, LLP; Amy W. Bizar of TIERI (The Education Resources Institute); Roland Brandel of Morrison & Foerster, LLP; Robert Channess of Digimarc Corporation; Alan Kapinsky of Ballard Spahr Andrews & Ingersoll, LLP; Jeffrey Langer of Dreher Langer & Tomkies L.L.P.; and William O’Connor, who is now retired.

The speakers offered historical perspectives on the consumer financial services practice and commented on current trends. The discussion covered developments in the law over the past 40 years, as well as the changing shape of the Committee during this time.

Panel members highlighted the increased level of federal involvement in the area of consumer financial services over the past 40 year period and how the Committee’s regular submission of formal comments to regulatory agencies and to Congress have helped shape this area of the law.

In addition to regulatory and judicial developments, the panelists remarked on the substantial growth of the Committee since its inception as well as the creation of increasingly active and specialized subcommittees. Particularly in more recent years, the Committee has focused on continuing its commitment to maintaining an active, diverse, membership.

Mr. Langer, the Chair of the Consumer Financial Services Committee from 2003-2006, concluded the forum by presenting his views and thoughts as to the future of the Committee.

Compliance Management and Privacy Joint Meeting -- How a Multinational Company Confronts the Matrix of International Privacy Laws

Ms. Ratte presented her issues first. Her initial inquiry was whether FAST would be considered a financial institution subject to Gramm-Leach-Billey. She asked if FAST was significantly engaged in financial activities. She stated that data is economic in nature and that data processing is a financial activity. She determined that FAST was likely a financial institution under GLBA. As such, if FAST was not regulated by a banking agency, it would be regulated by the FTC. Ms. Ratte proceeded to evaluate the type of information that was compromised, the sensitivity of the data, and the expectations involved in handling that data.

Next, the FAST Chief Privacy Officer (“CPO”) discussed what would be required when a breach occurs. The CPO is required to...
oversee compliance programs and to prevent and respond to data breach situations. The CPO should develop privacy programs, operation standards and procedures, develop employee training programs, and conduct assessments and audits of FAST’s privacy practices. The CPO is responsible for addressing any privacy issues or concerns that arise in any internal audits. After learning of the data security breach, the CPO consulted with his US counsel. The CPO was advised to ascertain the type of information that was compromised, and if sensitive, he was required to notify the banks whose customer information was improperly disclosed. FAST may have to notify consumers as well, but that would depend on the type of information compromised and how the banks would like to handle the matter in terms of disclosure.

To wrap up the discussion on the data security breach, FAST Asia counsel presented information on India’s laws and how India is working to protect consumer privacy. She explained that there are no over encompassing data security laws in India, but that India’s government is taking steps in that direction. India’s constitution aims to protect privacy as a right to protect life and the government passed an Information Technology Act to prevent cyber crimes. Most companies contractually ensure security standards and subject those contractual relationships to the laws of the country sending the data to India.

The Impact of Revised Article 9 on Consumer Credit Transactions

The Consumer Financial Services Committee in conjunction with the UCC Committee sponsored a joint session on the Ten Key Consumer Issues Under UCC Article 9. Barkley Clark and James White discussed various aspects of Revised Article 9 with which secured creditors and consumer debtors need to be concerned.

The panelists discussed the five major issues involved in a common UCC Article 9 case,

1. Was there a default?
2. Was there a breach of the peace during the repossession?
3. Were the repossessed goods sold, if so, did the sale conform to reasonable commercial standards?
4. Did the creditor give the debtor the appropriate pre and post sale notices?
5. If the creditor fails to perform according the rules in Article 9, what remedies are available to the debtor?

Various Sections of Article 9 deal with each of these issues. The remainder of the panel discussion dealt with specific applications of those various Article 9 sections, as well as common law variations.

Of the Ten Key Issues set forth by the panel, Mr. Clark and Mr. White touched on eight of those. The panel presented summaries of recent litigation addressing a dragnet clause in a consumer loan agreement. A recent case in Ohio, Wooding v. Cinfed Employees Federal Credit Union, 2007 WL 547655 (Ohio App. 2007), held that the dragnet clause was in effective because there was no meeting of the minds that the car would serve as collateral for a future credit card debt. The panel discussed the ramifications of this case as it relates to Article 9 as well as other case law addressing these dragnet clauses.

Next, the panelists discussed the potential for common law security interests in consumer deposit accounts despite the
exclusion of this practice under Article 9. The drafters of revised Article 9 commented that the exclusion did not prohibit consumer deposit accounts to serve as collateral, but left it to state laws and decisional law outside the reach of Article 9. Courts however, have been inconsistent in enforcing consensual security interests in consumer deposit accounts.

Following the deposit account discussion was a presentation regarding the conflict between free assignability of receivables under Revised Article 9 and the anti-assignment rules in consumer protection legislation. The panelists discussed a New Mexico case, Espinosa v. United of Omaha Life Ins. Co., 2006 WL 1867251 (N.M. Ct. App. 2006) and a Kansas case, DecisionPoint, Inc. v. Reece & Nichols Realtors, Inc., 2006 WL 3040636 (Kan. 2006). Both cases invalidated the assignments on different grounds, but the panelist surmised that there appears to be some judicial skepticism about the principal of individuals selling their rights. The panelists then addressed the scope of the term "purchase money obligation" as it relates to a security interest in a motor vehicle bought within 910 days of bankruptcy. The panelists argued that the definition of "purchase money" should be a federal definition. It is defined under Article 9, but it is not defined under the "hanging paragraph" of the 2005 bankruptcy amendments. This creates an uncertainty as to whether the whole debt is a part of the purchase money security interest or whether there are qualifying and nonqualifying parts. Examples are extended warranties or negative equity financed as part of the sale of the motor vehicle. If there are nonqualifying parts, are they merely excluded or does it render the entire debt a non purchase money obligation?

The discussion then turned to the topic of the UCC minimum civil penalty. A creditor can potentially open themselves up to the "double whammy" if they engage in any of a broad range of violations. A consumer can wipe-out a deficiency claim and have the minimum civil penalty imposed on the creditor. In addition to the "double whammy," a creditor also has to concern itself of the potential class action threat. The panelists suggested that case law appears to support the return of the "double whammy."

Messrs. Clark and White wrapped up the lively discussion by touching on the automatic perfection of purchase money security interests in consumer goods and the high cost of repossession. Cases under the old Article 9 favored the creditor where an affirmative representation of consumer use was included in the security agreement. The panelists suggested that this affirmative "consumer use" representation should be treated the same under the Revised Article 9, despite the lack of recent case law. The panelists turned to case law to show that a creditor and its agent can both be held liable for repossession violations.

Truth in Lending

The Truth in Lending subcommittee covered new developments in TILA disclosures, finance charges and points and fees. Julia Leah Greenfield of Wright, Finlay and Zak LLP, lead the panel with a presentation setting forth the various cases that illustrated these new developments. A handful of cases this year have held that a misleading disclosure is a violation of TILA to the same extent as a failure to disclose at all. This was followed by a discussion on the prohibition of directly related disclosures being included in the Federal Box and what "directly related" disclosures are allowed to be included. The panel addressed case law treatment of the failure to include in the Federal Box other security interests taken by the mortgage lender in addition to the secured real property, failure to give the required.
variable rate disclosure, and a failure to provide accurate notices of the right to cancel.

The panel highlighted and discussed the following cases in detail.

The court found that Chevy Chase's disclosures of the payment periods failed to comply with TILA, the APR disclosure was unclear, and that an ordinary consumer could have concluded that the interest rate was fixed for five years rather than the payments were fixed.

**McKenna v. First Horizon Home Loan Corp., 2007 WL 210850 (1st Cir. (D. Mass.) Jan. 29, 2007).**
The court held that class certification is unavailable as a matter of law for TILA rescission claims.

More comprehensive summaries of these cases and summaries of other cases published from January 1, 2007 and July 31, 2007 can be found at: [http://www.mavent.com/aba/TILACASESUMMARIES 7-31-07.pdf](http://www.mavent.com/aba/TILACASESUMMARIES 7-31-07.pdf)

**ABC's of Student Lending: Legal Issues in Financing the High Cost of Education**

The Consumer Financial Services Committee and the Banking Law Committee presented a joint panel on the ABC's of Student Lending. Luke Swarthout gave an overview of his testimony that he provided to the Senate Committee on Banking. He recommended to the committee that students should be provided with adequate information about the cost of private loans and the difference between private and federal loans when making their borrowing decisions. He advocated for better treatment in bankruptcy and more anti-fraud protection for student loan borrowers.

Next, the panel provided a brief discussion about the role of the government in student lending. The government administers and enforces the Federal Family Education Loan Program ("FFELP"). It pays interest on subsidized loans and assures lenders that they will receive certain returns on the loans. The most common loan is the Stafford loan. Interest accrues on the Stafford loans while the student is in school. The student can elect to pay the interest as it accrues or defer any payment until graduation. FFELP loans are excluded from TILA but the Higher Education Act requires its own disclosures. The lender must disclose the amount of the loan and any fees, whether they are deducted from the total loan amount or whether the borrower pays. The lender must disclose the rate and monthly payment amounts based on cumulative balances. There is a 14 day right to cancel.

Richard Hackett of Pierce Atwood presented material on regulatory activity in New York. The New York Attorney General, Andrew Cuomo, attacked various aspects of the student lending industry such as revenue sharing, emoluments for school officials affecting the Preferred Lender List ("PPL"), opportunity pools affecting the PLL, and blocking the use of lenders not on the PLL by "losing" school certifications. In a settlement agreement with NYU, Cuomo set forth the following remedies,

- Refund of revenue sharing profits to students
- Regulation of PLLs
- Equal Access to Master Promissory Notes

Cuomo also challenged Sallie Mae's lending practices which resulted in a settlement. The settlement agreement provided that
the lender could not provide anything of value to schools, such as revenue sharing, computers, etc., in exchange for any advantage. Sallie Mae must attempt to maintain borrower benefits, disclose any loan sale agreements to borrowers, and disclose student default rates and interest rates to the schools. These restrictions will have a negative impact on consumers to the extent that schools lose the ability to pool shopping power to depress rates and obtain better terms. Schools will not be able to negotiate underwriting terms. Cuomo issued a College Loan Code of Conduct that has since been incorporated into legislation. The Student Loan Sunshine Act, HR890, requires certain disclosures to be given to both schools and students. The schools must adhere to the code of conduct and they must promote FFELP loans as superior to private loans. Lenders may not market loans until the schools have finished the FFELP process with students and the lenders must disclose the loan details to the school before funding the loan.

Amendments to the Bankruptcy Act have been proposed to eliminate the student loan exemption from discharge.

Arthur Rotatori of McGlinchey Stafford PLLC wrapped up the discussion with a brief overview of the Equal Credit Opportunity Act and Regulation B. In connection with student lending, the question was presented whether different pricing by program of study violates ECOA/Reg. B? Students attending certain schools or choosing particular majors are perceived to have a lower default risk. If those loans are priced lower, are there ECOA implications?

**Young Lawyers Subcommittee**

Terry Franzén of Franzén & Salzano, P.C. opened the Young Lawyers Subcommittee session with a brief discussion about the Consumer Financial Services Committee generally, what the Committee does, and how she originally got involved. Subsequently, Emily Miller of Hudson Cook, LLP and Suzanne Haley of Franzén & Salzano, P.C., co-chairs of the subcommittee conducted a round table discussion to allow the young lawyers to share their ideas and requests for the direction of the subcommittee. The consensus was that the young lawyers would like to keep the sessions informal and utilize the time as a tool to ask questions and talk about industry issues. The subcommittee discussed the upcoming winter meeting and decided on a "Beer and Basics" format for the subcommittee session. The "Beer and Basics" will likely take place before the CFSC welcome reception and will provide the young lawyers with the opportunity to look over the upcoming programs and subcommittee panels. More experienced members of the CFSC have volunteered to help with the young lawyers and may be asked to come and sit in on the "Beer and Basics" to answer questions and provide insight, but the idea is to keep it a forum for the young lawyers to freely express ideas, opinions, and questions. The subcommittee also discussed avenues for getting involved in pro bono work and ways in which it can work with the pro bono subcommittee, including maintaining the Safeborrowing.org website and potential involvement with other financial literacy programs.

**Deposit Products and Payment Systems**

The Deposits Products and Payment Systems Subcommittee presented ACH 201. ACH 201 was a brief overview of the ACH system, how and why it started, and included a brief discussion of the ACH operating rules. The federal government was the first
major user of the ACH transfers for government benefits such as Social Security payments. ACH transfers have many benefits that paper checks do not including immediate availability.

**Internet Delivery/Electronic Banking**

The Internet Delivery/Electronic Banking Subcommittee presented an overview of fraud and security lapses on the internet including "phishing" and "pharming" for sensitive data such as credit card numbers, bank account numbers, and PINs and passwords, what industry leaders are doing to combat these schemes, and what bills Congress is trying to pass to combat these crimes. "Phishing" is the act of sending fraudulent e-mails to consumers to lure them by a link in the e-mail to a fraudulent website purporting to be that of a financial institution in an attempt to garner important financial information from the consumer, such as a social security number or PIN number. Approximately 109 million adults received phishing attacks this year, up from 57 million in 2004. Financial losses for 2006 are estimated at $2.8 billion. Under TiLA, the consumers are only liable for up to $50, so the losses are borne by merchants and banks. Phishing e-mails appear to be from a legitimate source.

"Pharming" gets the consumer user to the illegitimate website without using a link in an e-mail. Pharming came about because many consumers were being informed about the phishing schemes. Pharming hackers will create a website that has a domain name very similar to the targeted legitimate website. Typically these involve common misspellings, such as "Bankofamerican.com." The use of malware, such as viruses and Trojan Horses, also reroute consumers from legitimate websites to illegitimate ones. These programs can reroute consumers through illegitimate sites back to the original site, while capturing the user's keystrokes when they sign into their accounts. Other programs will write itself into the user's computer files fooling the computer into thinking that the illegitimate URL address is the correct address. The spyware bypasses the domain name server and inserts the illegitimate destination in its place.

Industry participants constantly battle these hackers by using various levels of encryption and authentication methods. Bank of America has instituted the use of sitekeys. When a user signs onto the Bank of America website, they will see a photograph that they have chosen as their sitekey. If the user does not see the sitekey, they are not on a Bank of America website. Existing authentication methods include information that a user knows (i.e. a PIN), something a user has (i.e. a card), or something the user is (i.e. a fingerprint).

Congress has passed legislation such as the Computer Fraud and Abuse Act which penalizes unauthorized access to a computer and the Patriot Act which increased the penalties for these types of activities. The House has repeatedly passed legislation entitled I-SPY and the SPY Act, which so far has not made it through the Senate.

The panel also discussed the basic history of the Federal Proposals on Electronic Disclosures. In 2001, the Fed came out with interim final rules on disclosures. Most were covered by E-Sign, but not all. The Federal system for delivering disclosures relied heavily on e-mail, but with the emergence of the phishing issue, the industry informed the Fed that this method would not work because it was not secure enough. The Fed lifted the
mandatory compliance requirement as a result. There has been no final action taken on the proposals.

Access to Services

The Access to Service subcommittee presented an update on an NAACP case alleging that African Americans received a disproportionate number of high cost loans compared to white borrowers. The NAACP claimed that African Americans were steered towards higher rate loans and they were more likely to be charged higher fees. The NAACP claimed that this was discriminatory. The complaint is based on 2004 price data and HMDA data. The NAACP complaint failed to list any specific borrowers.

Next the subcommittee discussed a number of state predatory lending statutes. Florida, Nevada, Maine, North Carolina, Massachusetts, and Michigan all have enacted predatory lending statutes. This year Minnesota introduced a residential originators bill. The bill prohibits churning (originating without a reasonable net benefit to the borrower). It requires the lender to orally inform the borrower about the terms of the loan and where there is no escrow, the lender must inform the borrower about property taxes and insurance payment obligations. The bill prohibits making, providing, or arranging a residential mortgage loan with any repayment option that would result in negative amortization. The bill also makes the broker an agent of the consumer. The bill includes a private right of action and an award attorneys fees to successful plaintiffs. There are also criminal penalties for deliberate, material, and willful misstatements.

Congress has introduced various bills to address predatory lending. Many of the bills required underwriting to the fully indexed payment. The bills all had provisions prohibiting stated income loans and requiring the verification of assets.

Debt Collection Practices and Bankruptcy

The Debt Collection Practices and Bankruptcy subcommittee presented a discussion on the litigation privilege as a defense to a FDCPA claim. Historically this has not provided a valid defense. However, it has barred some state law claims. In California, the privilege is available to give witnesses and attorneys the freedom to speak freely without being harassed by subsequent lawsuits and to encourage zealous prosecution and defense by attorneys. Any communication in anticipation of litigation is privileged. Under the FDCPA, attorneys are sued regularly for "incorrect statements of the debt." The FDCPA poses strict liability. Prior to 1986, attorneys were exempt from the FDCPA, but Congress removed the exemption. Certain circuits began to apply an attorney litigation "carve out." However, the 7th circuit held that when Congress removed the exemption, it subjected attorney debt collection activities to the FDCPA.

As recently as this year, we have seen a split among the circuits on this issue. A case out of the 6th circuit allowed the privilege to apply but a case in the District of Minnesota held there was no litigation privilege in FDCPA claims. Ultimately, the litigation exemption may not be applied broadly, but it might be available in certain Circuits.
Federal and State Trade Practices

The Federal and State Trade Practices subcommittee gave a presentation on gift cards and the imposition of dormancy fees. Dormancy fees are fees charged against the amount on a gift card if the card is not used or redeemed within a certain time frame. The panel addressed multiple gift card cases where the essential claim was that the consumer could redeem the gift card for goods or services in an amount stated on the card, but the card issuer failed to disclose that after a certain time dormancy fees applied to reduce the value of the card. A few of the cases resulted in consent orders which included injunctive relief. The relief generally consisted of a requirement that the existence of any dormancy fees or expiration dates be disclosed on the front of the card. The disclosure of fees or the expiration date must be clear and prominent in all advertising and all terms must be disclosed before the sale. In the Matter of Darden Restaurants, the FTC Decision and Order required Darden to remove any dormancy fees it had collected to the cards. In a similar settlement, Kmart will have to implement a refund program.

These types of consent orders can result in the establishment of industry standards. The industry will likely look to the FTC enforcement actions to determine their own actions in how to comply with these new disclosure requirements. The panel used a mock gift card PowerPoint to show how a gift card failed to comply with the disclosure requirements. Dormancy fees can be imposed, but they must be disclosed. The OTS has solicited comments in a recent ANPR in connection with gift card fees.

Preemption and Federalism

The Preemption and Federalism subcommittee presented an analysis of the Watters v. Wachovia case. The program started with a review of the background that led up to the case, the questions presented to the Supreme Court, and the ultimate ruling in favor of Wachovia. The Court held that Michigan’s statutes were preempted because they impair a national bank’s federal authority to exercise its powers through its operating subsidiaries. The Court rejected the 10th Amendment challenge. The Dissent argued that if Congress had wanted preemption, it should have enacted express preemptive statutory language.

After summarizing the decision, the panel discussed the impact of the decision. In the aftermath of Watters, the Supreme Court has denied certiorari in the Burke and Turnbaugh cases. The panel suggested that a direct action in response to Watters by Congress is unlikely and that there should be more pressure on federal regulators to enforce consumer protection rules, such as those promulgated under the FTC Act and HOEPA. The OCC has taken steps to work with states in connection with sharing consumer complaint information, has launched a website to provide customer assistance, has encouraged other regulators to join, and is developing new web-based platforms to expedite the sharing of consumer complaint information.

Open Microphone

Jeff Langer talked about suitability standards in connection with credit cards.

Alan Kaplinski spoke about the “truncation provision” in the FACT
Act and how retailers have not realized that it also requires the retailer to mask the expiration date. He discussed the Safeco case and its implication on prescreening cases brought under the FACT Act.

Don Lampe talked about Congressional predatory lending bills. He predicted that any bills introduced this Fall are likely to have underwriting restrictions.