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Financial Services Report

Editor's Note

Bawl Street

It is time to put on the cranky pants and have a full-on Gibson. (Named in honor of Mel, who thoughtfully reminded us this quarter what a real rant sounds like.) This is just a warm-up.

It is football preseason so we try to be open-minded—really we do—but we are not convinced that groin injuries are all that newsworthy. After all, no reporters were standing by, mic-in-face, worrying if bank lawyers would get a hernia from wrestling the 2,319-page Dodd-Frank bill to the ground. Yet, there we were, doing the smack down. Let's face it. We are the tackling dummies. The other side is trying to dance in our end zone. Football players at least have flashy laundry.

Can we not talk about Dodd-Frank? Or, at least, not unless we have something funny to say? The problem is the material. All the jokes are variations on "How many regulators does it take to screw in a light bulb?" For example, did anyone notice that Dodd-Frank devotes two pages to defining "unfair" and "abusive" practices but twenty-seven pages to explaining how the Consumer Financial Protection Bureau is going to be created? So much is left to later regulation that predicting what it will look like in the end is beyond the reach of even eight-armed "Octopus Paul," World Cup soccer prognosticator. In case the new Bureau is looking for a new logo, we have one: A thousand outstretched hands reaching upward to rotate a single—notably unlit—light bulb.

We learned this quarter that among North Korea's Kim Jong-il's 1,200 official job titles are "Guardian Deity of the Planet," "Lodestar of the 21st Century," and "Greatest Man Who Ever Lived." If you think about it, aside from the finger-on-the-nuclear-button duty, his other chores aren't too different from the job description of the still-unnamed head of the new consumer Bureau. This is only a "what if," but suppose the "Shining Star of Paektu Mountain" is willing to share one of his titles?

Maybe your pleasure inclines toward Dodd-Frank humor of the unintentional kind. In that case, you've come to the right place. We have issued a series of Dodd-Frank "User Guides." Our latest booklet on "Residential Mortgages" is a must-read at 100 pages: http://www.mofo.com/files/Uploads/Images/ResidentialMortgage.pdf, and our 32-page Mortgage Servicing User Guide can be found at http://www.mofo.com/files/Uploads/Images/100830User_Guide_Mortgage_Servicing.pdf. If you prefer preemption, check out our preemption User Guide: (http://www.mofo.com/files/Uploads/Images/100723UserGuide.pdf). You will want to keep these on your shelf. For our Dodd-Frank overview and our shorter Client Alerts, and still more User Guides to come, visit our website at: http://www.mofo.com/resources/regulatory-reform/. As we like to say, "Dodd-Frank R Us." (No one actually said that.)

Until next time, close the windows, treat yourself to a full-on Gibson, and change your light bulbs all by yourself.

William Stern, Editor-in-chief

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MoFo Metrics

40: Fatality rate, as a percent of all climbers of Annapurna

46: Average age of Harley-Davidson motorcycle owner

38: Percentage of Americans aged 18-29 sporting tattoos

8: Percentage of all U.S. milk produced that goes into ice cream

118: Number of U.S. bank closures this year

4-600: First year budget, new Consumer Financial Protection Bureau, in millions of dollars

300: Annual budget, entire FTC, in millions of dollars

50: Number of galaxies in the cosmos, in billions

Beltway Report

Dodd-Frank Act Signed into Law

On July 21, 2010, President Obama signed into law the Dodd-Frank Act. At 2,319 pages, there is a lot to absorb. Our presses have been working overtime issuing overviews, User Guides, and Client Alerts. For more information, visit our website at: http://www.mofo.com/resources/regulatory-reform.

Title X of Dodd-Frank creates a new Bureau of Consumer Financial Protection within the Federal Reserve Board. That Title, and Title XIV (implementing the Mortgage Reform and Anti-Predatory Lending Act), will matter most to financial services providers.

The Name is Bond, Covered Bond

On July 28, 2010, the Financial Services Committee of the House voted to send a covered bond bill to the full House. This is a significant step in the legislative process. The starting point for the Committee deliberations was legislation introduced by Representative Scott Garrett (R-NJ) on July 22, 2010. This was the fifth time that Rep. Garrett has introduced legislation to establish a statutory framework for U.S. banks to issue covered bonds. The legislation is similar to legislation Rep. Garrett introduced in March, with some changes to accommodate concerns that were raised during the Joint Congressional Hearings on the Dodd-Frank Act. At a markup hearing on July 28 before the House Financial Services Committee, there were a number of amendments to the bill that made some additional significant changes. The legislation is discussed in our Client Alert, which can be found at: http://www.mofo.com/files/Uploads/Images/100812CoveredBond.pdf.

For more information, contact Jerry R. Marlatt at jmarlatt@mofo.com.

Securitization Provisions of Dodd-Frank

The Dodd-Frank Act includes a number of provisions that will significantly impact the securitization industry. The securitization provisions of the Dodd-Frank Act focus on "credit risk retention" that would require originators and securitizers of financial assets to retain a portion of the credit risk of securitized financial assets or, in more popular terms, to have "skin in the game." In addition, the securitization provisions in the Dodd-Frank Act set forth disclosure requirements for the issuer and credit rating agencies who rate the issuer's securities.

DODD-FRANK CREATES A NEW BUREAU OF CONSUMER FINANCIAL PROTECTION WITHIN THE FEDERAL RESERVE BOARD. THAT TITLE, AND TITLE XIV (IMPLEMENTING THE MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT), WILL MATTER MOST TO FINANCIAL SERVICES PROVIDERS.

The securitization provisions of the Dodd-Frank Act are discussed in our client alert: http://www.mofo.com/files/Uploads/Images/100721SECABS.pdf.

For more information, contact Melissa D. Beck, mbeck@mofo.com, Jerry R. Marlatt, jmarlatt@mofo.com, Kenneth Kohler, kkohler@mofo.com, or Calvin Cheng, calvincheng@mofo.com.

Ch-Ch-Ch-Ch-Changes

Pursuant to the Dodd-Frank Act, the FDIC Board of Directors has approved the establishment of a new Office of Complex Financial Institutions ("CFI") and a new Division of Depositor and Consumer Protection ("DCP"). The CFI and the DCP are meant to assist the FDIC in meeting its obligations under the Dodd-Frank Act. The CFI will conduct continuous reviews and oversight of bank holding companies with more than $100 billion in assets, examine non-bank financial companies considered as systemically important by the Financial Stability Oversight Council created by the Dodd-Frank Act, and implement orderly liquidations of failing bank holding companies and non-bank financial companies.

The FDIC has also announced an open door policy to allow the public to provide input and track changes under the Dodd-Frank Act, which goes beyond the requirements of the Administrative Procedure Act. Under this policy, interested parties can request a meeting with FDIC officials or staffers, and the FDIC intends to provide increased disclosure concerning meetings between senior FDIC officials and private sector individuals, and disclose the names and affiliations of the private sector individuals and the subject matter of meetings. This voluntary public disclosure policy will apply to "meetings discussing how the FDIC should interpret or implement provisions of the Dodd-Frank Act that are subject to independent or joint rulemaking by the FDIC." The FDIC also intends to hold round table discussions with external parties on issues concerning implementing rules adopted under the Act.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

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Regulations on Anti-Money Laundering Requirements for Prepaid Providers

FinCEN published proposed regulations expanding anti-money laundering obligations under the Bank Secrecy Act for providers and sellers of prepaid access. The regulations are mandated by the Credit Card Accountability, Responsibility, and Disclosure Act of 2009, and are intended to fill the regulatory gap resulting from the spread of and innovation in prepaid access devices over the past 10 years, and their increased use as accepted payment methods. The regulations would apply to providers and sellers of prepaid access devices such as gift cards, mobile phones, electronic serial numbers, key fobs and other mechanisms providing a portal to funds that have been paid for in advance and are retrievable and transferable, who would have to establish AML programs and comply with CTR filing requirements. They would have to establish policies and procedures to verify the identity of customers who obtain prepaid access through a prepaid program and retain customer identifying information, including name, date of birth, address and identification number, for five years. They would also become subject to the SAR filing requirements as other types of money service businesses.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Let's Be Friends

The FDIC's Board of Directors voted to revise its Memorandum of Understanding with the primary federal banking regulators to enhance the FDIC's existing backup authorities over insured depository institutions that the FDIC does not directly supervise. The revised agreement will improve the FDIC's ability to access information necessary to understand, evaluate, and mitigate its exposure to insured depository institutions, especially the largest and most complex firms. Specifically, the revised MOU gives the FDIC backup supervision authority under an expanded list of circumstances, including when the insurance pricing system suggests an insured depository institution might be at higher risk, when institutions are defined as "large" under international regulatory guidelines, or when large, interconnected bank holding companies are defined as "systemic" by the financial reform legislation pending in Congress. The MOU broadens the definition of insured depository institutions ("IDI") to include four groups. Once identified, problem IDIs and heightened risk IDIs will trigger targeted reviews for insurance purposes. At large, complex IDIs, and TLGP-IDIs, the FDIC will establish a continuous on-site full-time staff presence with the number of staff depending on the size of the IDIs. The MOU also covers how the FDIC and the other agencies will coordinate activities on an on-going basis, and handle differences in CAMELS ratings.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Alternatives to the Use of Credit Ratings in the Regulatory Capital Guidelines

The federal banking agencies have published an advance notice of proposed rulemaking regarding alternatives to the use of credit ratings in their risk-based capital rules for banking organizations. The advance notice is issued in response to section 939A of the Dodd-Frank Act, which requires the agencies to review regulations that require an assessment of the credit-worthiness of a security or money market instrument, and contain references to or requirements regarding credit ratings. The agencies are required to remove such references and requirements and substitute in their place uniform standards of credit-worthiness, where feasible. Through this advance notice, the agencies are seeking to gather information as they begin to develop alternatives to the use of credit ratings in their capital rules. This advance notice describes the areas in these capital rules where the agencies rely on credit ratings, as well as the Basel Committee on Banking Supervision's recent amendments to the Basel Accord. The advance notice addresses only the references to credit ratings in the agencies' capital rules, and are expected to issue proposals for removing references to credit ratings in other parts of their regulations separately. Comments are solicited 60 days after publication in the Federal Register, which is expected shortly.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Getting Credit

The federal bank and thrift regulatory agencies announced a proposed change to the Community Reinvestment Act ("CRA") regulations to support stabilization of communities affected by high foreclosure levels. The proposed change would encourage depository institutions to support the Neighborhood Stabilization Program administered by the U.S. Department of Housing and Urban Development ("HUD"), under which HUD has provided funds to state and local governments and nonprofit organizations for the purchase and redevelopment of abandoned and foreclosed properties. The proposal would encourage depository institutions to make loans and investments and provide services to support NSP activities in areas with HUD-approved plans. For NSP areas identified in HUD-approved plans, the agencies would provide CRA consideration for activities that benefit individuals with incomes of up to 120 percent of the area median and geographies with median incomes of up to 120 percent of the area median. Comments on the proposed rule must be submitted no later than 30 days from the date of its publication in the Federal Register, which is expected shortly.

The agencies also conducted a series of public hearings on modernizing the regulations that implement the CRA, and

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interested parties were invited to provide testimony and written comments. The agencies considered ways to update the regulations to reflect changes in the financial services industry, changes in how banking services are delivered to consumers, and housing and community development needs, and wanted to ensure that the CRA remains effective for encouraging institutions to meet the credit needs of communities.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Incentive Comp (or Show Me the Money)

The Federal Reserve, the OCC, the OTS, and the FDIC issued final guidance, originally proposed by the Federal Reserve last year, to ensure that incentive compensation arrangements at financial organizations take into account risk and are consistent with safe and sound practices. The agencies have completed a first round of in-depth analysis of incentive compensation practices at large, complex banking organizations as part of their horizontal review, a coordinated examination of practices across multiple firms. The agencies will conduct additional cross-firm, horizontal reviews of incentive compensation practices at large, complex banking organizations for employees in certain business lines, such as mortgage originators, and will follow up on specific areas found to be deficient at many firms. The agencies are also working on incorporating oversight of incentive compensation arrangements into the regular examination process for smaller firms. The guidance is meant to ensure that incentive compensation arrangements at banking organizations appropriately tie rewards to longer-term performance and do not undermine the safety and soundness of the firm or create undue risks to the financial system. The guidance applies not only to top-level managers, but also to other employees who have the ability to materially affect the risk profile of an organization, either individually or as part of a group. The guidance will become effective when published in the Federal Register, which is expected shortly.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Stop Being a Good Host

The Federal Reserve Board, the FDIC, and the OCC issued the host state loan-to-deposit ratios that the banking agencies will use to determine compliance with section 109 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. which prohibits a bank from establishing or acquiring a branch or branches outside of its home state primarily for the purpose of deposit production. Section 109 also prohibits branches of banks controlled by out-of-state bank holding companies from operating primarily for the purpose of deposit production. These ratios update data released on June 29, 2009. Section 109's two-step compliance process involves a loan-to-deposit ratio screen that compares a bank's statewide loan-to-deposit ratio to the host state loan-to-deposit ratio for banks in a particular state; and if a bank's statewide loan-to-deposit ratio is less than one-half of the published ratio for that state, or if data is not available at the bank to conduct the first step, a determination by the appropriate banking agency of whether the bank is reasonably helping to meet the credit needs of the communities served by the bank's interstate branches.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Operations Report

Dodd-Frank

On the operations side, the Dodd-Frank Act permanently raised the current standard maximum deposit insurance amount to $250,000, which had been previously raised temporarily from $100,000 to $250,000 until December 31, 2013. This insurance coverage limit applies per depositor, per insured depository institution for each account ownership category. The Act also made this increase retroactive to January 1, 2008. That means that the $250,000 deposit insurance amount applies to banks that failed between January 1 and October 3, 2008, and this has reduced the number of uninsured depositors at these failed institutions from more than 10,000 to approximately 500.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Judge ODs on ODs

A federal judge in San Francisco, following a two-week trial, issued a lengthy opinion in an "order-of-posting" class action finding that Wells Fargo Bank is liable for approximately $203 million in overdraft fees imposed on California depositors. Gutierrez, et al. v. Wells Fargo Bank, N.A.,—F. Supp. 2d—, 2010 WL 3155934 (N.D. Cal. Aug. 10, 2010). Similar order-of-payment challenges are pending against 32 banks in Miami.

According to Judge Alsup, the bank engaged in a bookkeeping practice ("high to low sequencing") that was intended to turn one overdraft into as many as ten, and that this was not adequately disclosed in the customer account agreements or the marketing materials. The court enjoined the practice of "high-to-low posting" as of November 30, 2010, and ordered restitution measured by the difference between the overdraft fees that were actually imposed and those that would have been imposed using a different posting scenario, i.e., one

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of the alternative scenarios advanced by plaintiff's expert. The court noted that this amount will be close to $203 million.

For more information, contact James McGuire at jmcguire@mofo.com.

OD Payment Guidance

Speaking of overdraft programs, the FDIC proposed guidance on automated overdraft payment programs. The proposal focuses on finding effective ways for banks to monitor their overdraft programs for excessive or chronic use by customers as a form of short-term, high-cost credit instead of its intended use: protection against inadvertent overdrafts. It also provides an overview of how banks can avoid compliance and safety-and-soundness risks. Unlike Regulation E's opt-in requirement which applies only to paying overdrafts resulting from one-time debit card and ATM transactions, the FDIC's proposal states that customers should have an opportunity to opt out of the payment of overdrafts resulting from non-electronic transactions such as checks. The FDIC's proposal instructs banks to not process transactions in a manner designed to maximize the cost to customers, and to monitor accounts and take actions to limit customer use of overdraft coverage as a form of short-term, high-cost credit, for example, by giving customers who overdraw their accounts on more than six occasions where a fee is charged in a rolling 12-month period a reasonable opportunity to choose a less costly alternative and decide whether to continue with fee-based overdraft coverage. The FDIC expects banks to institute appropriate daily limits on overdraft fees, and will review overdraft payment programs during examinations. Comments on the Proposal are due by September 27, 2010.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

New Math: BASEL 3.0 Equals Mortgage Servicing Hit

The Basel Committee on Banking Supervision ("BCBS") published two consultative documents in July proposing significant reforms to the Basel II framework. These relate to, among other things, the definition of capital, the treatment of counterparty credit risk, the introduction of a leverage ratio and the imposition of global liquidity standards (the "December 2009 Proposal"). Following an extensive consultation process during which many concerns were raised as to the scope and effect of the December 2009 Proposal, including concerns that many banks and financial institutions may be unable to function with the increased capital and liquidity requirements (at least until there is a significant economic recovery), BCBS announced on July 26 that its oversight body had reached agreement on proposed capital and liquidity reforms. It also announced that it intended to finalize the calibration and phase-in arrangements for the reforms at a meeting in September 2010.

On July 16, BCBS also published its countercyclical buffer proposals for public consultation, which will continue until September 10. Part of these proposals was outlined in the December 2009 Proposal. Although the proposals in its July 2010 papers do not alter the overall thrust of the December 2009 Proposal in relation to capital and liquidity requirements, they do include some important modifications and softening of some of BCBS's earlier proposals, including substantially deferring the transitional period for the global minimum Tier 1 leverage ratio and the net stable funding ratio.

Bottom line: The proposed updates would force U.S. banks with large mortgage servicing portfolios to take a multibillion-dollar regulatory capital hit. Mortgage servicing assets would be counted as 10% of Tier 1 capital at most, and even less if the bank has large holdings of deferred tax assets or other intangible assets. Though more favorable than the earlier version (which would have entirely excluded mortgage servicing rights from regulatory safety measures), the proposal is still more stringent than the current 50% cap for U.S. banks.

The key features of the BCBS proposals are discussed in our Client Alert, which can be found at: http://www.mofo.com//files//Uploads/Images/100806BaselCapital.pdf.

For more information, contact Peter Green at pgreen@mofo.com or Helen Kim at hkim@mofo.com.

Super-Absorbent

On August 19, the BCBS refined its views on the features capital instruments must possess in order to be acceptable as regulatory capital. There, BCBS expresses its view that all bank regulatory capital instruments must be capable of absorbing loss (at least) in "gone-concern situations." By gone-concern situations, BCBS is referring not only to insolvency or liquidation situations (in which circumstances it notes that all bank regulatory capital instruments qualify as "loss-absorbent") but also the situations where the relevant bank fails without public sector support. In this regard, BCBS believes that any government injection of capital to rescue a failing bank should not be applied to protect the holders of regulatory capital instruments.

For our Client Alert on the August 19 pronouncement, see our Client Alert at http://www.mofo.com/files/Uploads/Images/100825SuperAbsorbent.pdf. For more on Basel III generally, see our prior alerts and presentations at: http://www.mofo.com/resources/regulatory-reform/.

For more information, contact Jeremy Jennings-Mares at jjenningsmares@mofo.com or Helen Kim at hkim@mofo.com.

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Plastic (a/k/a Card Report)

Final Credit Card Act Changes Kick In Finally

On August 22, the final changes took effect to the Credit Card Accountability, Responsibility and Disclosure Act of 2009. Card issuers could lose an estimated $3 billion in revenue annually.

In prior issues, we reported on these changes, which result in the most comprehensive overhaul ever of the credit card industry. As we reported, most of the changes took place in February, including consumer protections against interest rate increases, billing practices, and restrictions on various fees. The rules that went into effect in August (i) require that "penalty fees" be reasonable and proportional, (ii) ban inactivity fees, and (iii) require card issuers to review, every six months, accounts that have had rate increases to see if the higher rate is still warranted.

For more information, see our Client Alert (http://www.mofo.com//files//Uploads/Images/100407GiftCard.pdf) or contact Rick Fischer at rfischer@mofo.com or Ollie Ireland at oireland@mofo.com.

Mortgage Report

When it rains, it pours. This last quarter has seen the mortgage industry inundated with new requirements, stemming from the Dodd-Frank legislation as well as a recent spasm of Federal Reserve Board rulemaking. This Section covers all that. We start with Dodd-Frank, then turn to the Board's new rules, and end with a potpourri of other news.

Dodd-Frank on Mortgages

Titles X and XIV of the Dodd-Frank Act include a raft of new mortgage-related requirements, some of which must be implemented by rules to be made by the new Consumer Financial Protection Bureau ("CFPB") or existing agencies and others of which are self-executing.

These are game-changers, beyond what we can treat here. To give our readers a sense of their scope, the new rules include such things as integrated mortgage disclosures; greatly expanded HMDA reporting requirements; new duty of care obligations on the part of mortgage loan originators; a ban on yield-spread premiums and "steering incentives; limitations on prepayment penalties; a prohibition of single premium credit insurance and arbitration clauses; restrictions on the ability to originate mortgages resulting in negative amortization; a variety of new notices and disclosures; various new requirements governing appraisals, including a "super appraisal" requirement for a new class of "higher risk" mortgages; new responsibilities for servicers; and increased protections for tenants of foreclosed properties.

We have issued comprehensive client alerts addressing these reforms as applied to mortgage originators, and have prepared a 100-page User Guide on how Dodd-Frank affects "Residential Mortgages." *See* http://www.mofo.com/files/Uploads/Images/ResidentialMortgage.pdf. We have also issued a 32-page Mortgage Servicing User Guide. *See* http://www.mofo.com/files/Uploads/Images/100830User_Guide_Mortgage_Servicing.pdf.

A Blizzard of White—The Board's Rulemaking Notices

The Federal Reserve Board was working overtime in August. On August 16, 2010, it issued enough rules to account for all the fingers on one hand: three final rules and two proposed rules governing mortgages and HELOCs.

Final Rule #1—Disclosure Re Acquiring Legal Title to a Mortgage Loan

Section 131(g) of TILA, added in May 2009, requires a creditor that is the new owner or assignee of a mortgage loan to provide a written notice to the consumer on the loan within 30 days of the sale, transfer or assignment of the loan. Late last year, the FRB issued an interim rule, 12 CFR § 226.39, to provide guidance relating to compliance with Section 131(g) of TILA. This final rule tweaks the interim rule and provides some clarifications. The mandatory compliance date is January 1, 2011.

Our Client Alert discusses the who, what, when, where, and how of compliance. *See* http://www.mofo.com/files/Uploads/Images/100823FinalRule.pdf.

For more information, contact Joe Gabai at jgabai@mofo.com or Andrew Smith at asmith@mofo.com.

Final Rule #2—YSPs, and Loan Originator Compensation Practices

Today, it is not uncommon for lenders to pay loan originators more compensation if the borrower accepts an interest rate higher than the rate required by the lender (commonly referred to as a "yield spread premium"). That will change April 11, 2011.

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The final rule, which applies to closed-end loans secured by a consumer's dwelling, will: (i) Prohibit payments to the loan originator that are based on the loan's interest rate or other terms, but compensation based on a fixed percentage of the loan amount is permitted; (ii) Prohibit a mortgage broker or loan officer from receiving payments directly from a consumer while also receiving compensation from the creditor or another person; (iii) Prohibit a mortgage broker or loan officer from "steering" a consumer to a lender offering less favorable terms in order to increase the broker's or loan officer's compensation; and (iv) Provide a safe harbor to facilitate compliance with the anti-steering rule.

The final rule applies to loan originators, which are defined to include mortgage brokers, including mortgage broker companies that close loans in their own names in table-funded transactions, and employees of creditors that originate loans (e.g., loan officers). Thus, creditors are excluded from the definition of a loan originator when they do not use table funding, whether they are a depository institution or a non-depository mortgage company, but employees of such entities are loan originators.

For more information, contact Joe Gabai at jgabai@mofo.com.

Proposed Rule—Mumbo for Jumbos

On August 16, the Board also issued a proposed amendment to the rule about disclosures of mandatory escrow accounts for "jumbo" loans, i.e., loans with a principal balance at consummation that exceeds the maximum principal obligation in effect as of the date that the interest rate is set for the loan to be eligible for purchase by a government-sponsored enterprise ("GSE").

Under the proposed amendment, a first lien loan that is a "jumbo" loan will be subject to the mandatory escrow account rule only if the APR exceeds the average prime offer rate for a comparable transaction as of the date that the interest rate is set by 2.5% or more. The current Freddie Mac conforming loan limit is $417,000 for a single-family loan that is not located in any of the various designated high-cost areas. The comment period runs for 30 days following publication of the proposal in the Federal Register.

Our Client Alert (http://www.mofo.com/files/Uploads/Images/100818Escrow.pdf) summarizes the Board's proposal relating to mandatory escrow account requirements for first lien higher-priced mortgage loans ("HPMLs").

For more information, contact Joe Gabai at jgabai@mofo.com.

Interim Rule—Disclosure of Interest Rate/Payment Summary for Mortgage Loans

The current rule on disclosing payment schedules for closed-end loans is found in Section 226.18(g) of Regulation Z, which requires a disclosure of the number, amounts, and timing of payments scheduled to repay the obligation. For mortgage loans with introductory interest rates, rate caps, payment caps, interest-only features, negative amortization, mortgage insurance, step rate, step payment, or other unique features, the payment schedule will have multiple phases often, five or more–each set forth on a separate line.

The Board's interim rule applies to closed-end credit transactions secured by real property or a dwelling, but excludes loans secured by consumers' interests in certain timeshare plans. Under the interim rule, the payment schedule disclosure requirements contained in Section 226.18(g) of Regulation Z remain in place, but will apply only to loans that are not secured by real property or a dwelling. For loans that are secured by real property or a dwelling, a new Section 226.18(s) will govern. Section 226.18(s) requires an interest rate and payment summary for these mortgage transactions, rather than an exact payment schedule reflecting every payment due for every phase of the loan. Moreover, Section 226.18(s) requires disclosure of the interest rates that are applicable at various times during the loan term, something that Section 226.18(g) neither requires nor tolerates. In addition, a new Section 226.18(t) will require a disclosure that there is no guarantee that the consumer can refinance the loan to lower the interest rate or periodic payments.

Compliance with the new rule is optional until January 30, 2011. Compliance is mandatory for applications received on or after that date. Comments on the interim rule may be provided to the Board for 60 days following publication in the Federal Register. Other amendments affecting payment disclosures are likely at a later time.

Our Client Alert (http://www.mofo.com/files/Uploads/Images/100820InterimRule.pdf) summarizes the Board's interim rule.

For more information, contact Joe Gabai at jgabai@mofo.com.

TILA Disclosure Threshold Being Raised

On July 3, the Board raised to $592 the amount of fees that triggers additional disclosure requirements under the TILA and HOEPA for home mortgage loans that bear rates or fees above a certain amount. The adjustment is effective January 1, 2011. This adjustment does not affect the rules for "higher-priced mortgage loans" adopted by the Board in July 2008. Coverage of mortgage loans under the July 2008 rules is determined using a different rate-based trigger.

For more information, contact Joe Gabai at jgabai@mofo.com.

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Better SAFE Than Sorry

The federal banking agencies issued a final rule on the registration of employees acting as mortgage loan originators for banks, savings associations, credit unions, and their subsidiaries. The rule implements the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, which requires mortgage loan originators employed by banks to register with the Nationwide Mortgage Licensing System and Registry. The rule does not require registration of individuals involved in mortgage modifications, assumptions, and servicing unless they originate new loans. The rule is effective October 1, 2010. The agencies do not expect that the Nationwide Mortgage Licensing System and Registry will be ready to accept mortgage loan originator applications before January 28, 2011, and individuals will have 180 days to register after the Nationwide Mortgage Licensing System and Registry begins accepting applications.

For more information, contact Joe Gabai at jgabai@mofo.com.

The Monster That Ate Cleveland

On July 27, the Sixth Circuit affirmed a district court's decision to dismiss a public nuisance lawsuit filed by the City of Cleveland against 22 financial institutions. In the lawsuit, the City claimed that defendants' financing, purchasing, and pooling of subprime mortgages led to a foreclosure crisis in Cleveland. The court noted that intervening causes of the injuries alleged by the City included the homebuyers' voluntary choice to enter into a subprime mortgage and default on their loans, homeowners' failure to maintain their properties, criminal conduct by drug dealers, and looters. The court also noted that properties not subject to subprime loans had entered into foreclosure as well. Let's hope Cleveland didn't spend stimulus money on this one.

For more information, contact Michael Agoglia at magoglia@mofo.com.

Fannie, Freddie Confab

Even a human rights trial in The Hague moves faster than this. On August 17, the Treasury Department held a conference to discuss GSE reform. The conference was scheduled in response to a deadline of January 2011, imposed by the Dodd-Frank law, for Treasury to come up with a plan for overhauling housing finance.

Whatever the eventual outcome, Secretary Geithner put down a marker in the August 17 meeting. In his opening remarks, he made clear that the GSEs will not remain unchanged, if he has anything to say about it: "We will not support returning Fannie and Freddie to the role they played before conservatorship, where they fought to take market share from private competitors while enjoying the privilege of government support."

According to press reports, participants appeared to support the development of a public insurance fund, similar to the FDIC, to cover catastrophic losses on mortgage-backed securities.

HVCC Bites Dust

The Dodd-Frank law mandates interim regulations by late October to eliminate the Home Valuation Code of Conduct ("HVCC"). The FRB to is required issue interim regulations within 90 days of Dodd-Frank's date of enactment (July 21, 2010) defining acts and practices by home lenders and others that could violate appraiser independence. Upon publication of those rules, the HVCC will sunset.

The HVCC applies to all loans backed by the GSEs, and has been a *bête noire* for mortgage bankers and realtors who believe that its appraiser independence requirements have led to slow and inaccurate appraisals—sometimes even resulting in homebuyers being unable to get financing. Nonetheless, the Dodd-Frank law includes detailed new appraisal independence requirements which will supplant the much-maligned HVCC. In addition, regulators, including the new Consumer Financial Protection Bureau are given broad authority to set appraisal rules. In our opinion, appraisal standards will continue to be an unsettled battleground.

Privacy Report

Dodd-Frank Do Privacy

Among the many powers the Dodd-Frank Act confers on the new Consumer Financial Protection Bureau ("CFPB") is oversight over privacy, for example, the Fair Credit Reporting Act (but not the red-flags and disposal requirements) and the Gramm-Leach-Bliley Act privacy (but not the data security requirements of section 501(b)). It also amends the FCRA privacy and security requirements in many respects, including requiring that credit scores be included in adverse action and risk-based pricing notices; that the Commodity Futures Trading Commission and the SEC write red-flags rules and guidelines; and that the CFTC write affiliate marketing rules.

For more information, please contact Andrew Smith at asmith@mofo.com.

FTC Issues Proposed Rule on Credit Reporting Agency Notices

On August 16, the Federal Trade Commission ("FTC") issued proposed revisions to the following model notices that consumer reporting agencies are required to provide to consumers and businesses under the FCRA: (1) a summary of consumer rights under the FCRA; (2) a notice to users of consumer reports regarding their obligations under the FCRA; and (3) a notice to furnishers of consumer report information regarding their obligations under the FCRA. The FTC has not revised these model notices since 2004. These proposed revisions are designed to reflect new rules that have been adopted since the FCRA was amended in 2003 (e.g., the risk-based pricing rules), as well as to make the notices more useful and easier to understand. The FTC is accepting public comments on the proposed changes until September 21, 2010.

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Receipt Truncation

On August 10, the Seventh Circuit ruled that the FCRA provision that prohibits a merchant from printing more than the last 5 digits of a credit or debit card number or the card expiration data on receipts provided to the cardholder at the point of sale does not apply with respect to e-mailed payment confirmations for online purchases. Shlahtichman v. 1-800 Contacts Inc., 7th Cir., No. 09-4073 (Aug. 10, 2010). The FCRA limitation applies only with respect to receipts that are "electronically printed." See 15 U.S.C. § 1681c(g). Following the majority of districts courts that have addressed the issue, the Seventh Circuit concluded that the phrase "electronically printed" covers receipts that are printed on paper using an electronic device, but not to on-screen "printing." Moreover, the Seventh Circuit concluded that the use of the word "electronically" did not expand the statute's coverage to on-screen displays, but was intended to distinguish among methods of creating paper receipts.

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Illinois Bans Employer Credit Checks

On August 10, Illinois Governor Quinn signed into law H.B. 4658, which will generally prohibit employers from inquiring about or using an applicant or employee's credit history or credit report. The law, however, does not prohibit an employer from conducting a background investigation or obtaining a consumer report or investigative report relating to an applicant, so long as the report does not contain information on the individual's credit history, which is defined as an individual's past borrowing and repayment behavior. This Illinois law, which will become effective on January 1, includes a number of pertinent exceptions. For example, the law's credit history related prohibitions in the employment context will not apply to, for example, employers in industries dealing with banking, insurance, trade secrets, or state and national security.

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Hot Tub Time Machine

Someone must have forgotten to check the settings on the hot tub time machine. After more than five years, Congress has again turned its attention to passing broad-based data security legislation. Although other issues, such as financial reform, have dominated the news, a number of lawmakers have expressed hope that Congress will pass a broad-based data security bill this year. For example, in December 2009, the House approved a data security bill (H.R. 2221), and various Senate committees are currently considering various data security bills, including, for example, S. 1490 and S. 3579. These bills would require that the FTC adopt rules requiring that businesses that handle personal information relating to consumer implement risk-based information security programs to protect such information. Moreover, the bills frequently include a nationwide standard for security breach notification, possibly preempting the various state laws. While there has been broad support in Congress for enacting data security legislation, jurisdictional issues and competing bills have complicated efforts toward final passage.

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THE SEVENTH CIRCUIT CONCLUDED THAT THE USE OF THE WORD "ELECTRONICALLY" DID NOT EXPAND THE STATUTE'S COVERAGE TO ON-SCREEN DISPLAYS, BUT WAS INTENDED TO DISTINGUISH AMONG METHODS OF CREATING PAPER RECEIPTS.

California Legislature Tinkers With Breach Notification Law

Although forty-six states, as well as the District of Columbia, Puerto Rico and the U.S. Virgin Islands, have enacted security breach notification laws, states continue to consider modifications to their existing laws. For example, on August 18, the California legislature once again approved a bill (S. 1166) that would amend the state's security breach notification law. If signed by the Governor, the amendment would, among other things, provide requirements for the content of notices that businesses must send to consumers when there is a security breach. Moreover, the amendment would require that businesses notify the California Attorney General of breaches involving more than 500 state residents. S.B. 1166 is substantially similar to two previous bills that have been approved by the California legislature and then ultimately vetoed by the Governor.

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Arbitration Report

Dodd-Frank Doodle

Congress might not have banned mandatory consumer arbitration altogether in the Dodd-Frank Act, but it dynamited a bunch of obstacles. Section 1028 of the Act requires the new Bureau of Consumer Financial Protection, which has jurisdiction over consumer contracts for the sale of financial products and services, to conduct a study of the use of mandatory pre-dispute arbitration in contracts under its jurisdiction and report back to Congress. The Bureau then has the authority, by rulemaking, to "prohibit or impose conditions or limitations on the use of" mandatory arbitration clauses, consistent with the study, provided that the Bureau "finds that such prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers." In addition, Section 1414 of the Act bans pre-dispute arbitration in residential mortgages and home-equity loans without the need for further study or rulemaking. The Act also confers similar authority on the SEC to ban mandatory arbitration in the securities context and bans mandatory arbitration that would waive protections for those who blow the whistle on securities fraud and commodities fraud.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

Supremes Cover Consumer Arbitration

As Diana Ross once sang, "You keep me hangin' on." And now the other Supremes are picking up the tune. As we reported last time, consumer arbitration caught the eye of the Supreme Court. This summer alone, the Court issued two important opinions on arbitration. In Rent-A-Center, West, Inc. v. Jackson, 130 S. Ct. 2772 (U.S. June 21, 2010), the Court settled a circuit split over whether the district court is in all cases required to determine whether an arbitration agreement is unconscionable even where the parties have contractually agreed that this is an issue to be resolved by the arbitrator. In a 5-4 decision, written by Justice Scalia, the Court held that the answer depends on what kind of challenge to the agreement is made: If a party challenges specifically the enforceability of the provision that the arbitrator will determine the enforceability of the agreement, the district court considers the challenge. But if a party challenges the enforceability of the agreement as a whole, the challenge is for the arbitrator.

In Granite Rock Co. v. Int'l Broth. of Teamsters, 130 S. Ct. 2847 (U.S. June 24, 2010), the Court held, in a 7-2 decision authored by Justice Thomas, that the question of when parties formed an agreement containing an arbitration clause is generally an "issue for judicial determination," not an arbitrator. The underlying dispute involved the formation date of a collective bargaining agreement and who should decide that question. To determine whether the parties' dispute over the agreement's ratification date is arbitrable, the Court held that it is necessary to apply the rule that a court may order arbitration of a particular dispute only when the parties agreed to arbitrate that dispute. The Court explained that under the agreement, arbitration is required only when a dispute "arise[s] under" the agreement–which a dispute over when the agreement was formed does not.

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Life After Stolt-Nielsen

We recently reported on the U.S. Supreme Court's decision in Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., No. 08-1198 (U.S. Apr. 27, 2010), in which the Court held that the Federal Arbitration Act does not allow class arbitrations absent an agreement between the parties in their arbitration clauses. The Second Circuit recently grappled with Stolt-Nielsen in connection with a student loan agreement that contained a class action waiver. In Fensterstock v. Education Finance Partners, 2010 U.S. App. LEXIS 14172 (2d Cir. July 12, 2010), the panel held that the waiver was unconscionable under California law, but that plaintiff could not proceed with class arbitration because "excising" the waiver from the agreement "leaves the [agreement] silent as to the permissibility of class-based arbitration, and under Stolt-Nielsen we have no authority to order class-based arbitration."

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Preemption Report

Dodd-Frank— The CliffNotes® Version

It's an understatement to say the "Consumer Financial Protection Act," Title X of the Dodd-Frank Act, includes extensive preemption provisions. For a comprehensive analysis, read our User Guide at http://www.mofo.com/files/Uploads/Images/100723UserGuide.pdf. For an overview of the key provisions on one of the three types of preemption addressed by the CFPA–whether certain state laws apply to national banks or federal thrifts ("charter preemption")–read on.

The CFPA addresses only charter conflicts involving a "state consumer financial law," which is defined in the statute. The existing preemption framework continues to apply to any state laws not covered by the definition. State consumer financial laws are preempted only if one of three conditions is met. The condition on which lenders will rely most frequently specifically references the legal standard for preemption in the Barnett Bank decision, and a colloquy in the legislative history confirms it is intended to codify the Barnett Bank standard.

The OCC or the courts decide whether state consumer financial laws are preempted. The OCC must: act on a case-by-case basis, consult the Bureau of Consumer Financial Protection and take its views into account, and act by regulation or order. Its determination must be supported by "substantial evidence, made on the record of the proceeding," and courts reviewing these determinations have broad discretion to assess their validity.

The CFPA brings preemption standards for federal thrifts into parity with national banks; neither the NBA nor HOLA "occupies the field in any area of state law." The statute also overrules Watters and eliminates charter preemption for

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operating subsidiaries and affiliates. It does, though, expressly preserve the interest rate exportation doctrine.

The CFPA is prospective only and does not affect contracts in existence before the date of enactment. However, the statute does not become effective until the "designated transfer date," which could be as late as 18 months from the enactment date.

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Appraise This

A New York appellate court held HOLA and OTS regulations do not preempt claims brought by the NY AG against appraisal management companies hired by Washington Mutual, alleging those companies permitted Washington Mutual to select appraisers who would improperly inflate a property's loan value to a targeted loan amount. People v. First American Corp., 902 N.Y.S.2d 521 (App. Div. 2010). The court rejected defendants' argument that HOLA or FIRREA occupy the field of appraisal practices, that appraisal services are one of the areas of state law expressly preempted by OTS regulation 12 C.F.R. § 560, and that defendants' actions were protected because they were acting as a federal thrift's agent engaging in an authorized bank activity.

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It's Officially a Trend

A federal court in Florida followed decisions by the Fifth Circuit and several district courts in holding a state statute prohibiting banks from charging check-cashing fees to non-depositors preempted as applied to national banks. Baptista v. JP Morgan Chase Bank, N.A., 10-cv-139, 2010 WL 2342436 (M.D. Fl. June 4, 2010). The court deferred to the OCC's interpretation of the NBA and its own regulations as authorizing national banks to charge these fees, noting "cashing of checks presented by the payee in person" is a "quintessential banking activity" that "falls squarely within the incidental powers granted national banks by the NBA." Id. at *5.

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Washed Out in Washington

The Supreme Court of Washington ruled en banc that plaintiffs' state law claims challenging fees charged by a federal thrift in connection with reconveyance of title were not preempted by HOLA and OTS regulations. McCurry v. Chevy Chase Bank, 233 P.2d 861 (Wash .2010). The court characterized plaintiffs' claims as alleging the federal thrift charged fees it expressly agreed not to charge under the terms of the deed of trust, reasoning claims alleging a party failed to comply with or misrepresented the terms of its contract are claims of general applicability and are not preempted. The court held that, to the extent plaintiffs contend how or when a federal thrift can charge loan-related fees, those claims are preempted.

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Not So Fast

A federal district court in San Francisco denied a motion by the successor to a federal thrift to dismiss as preempted state law claims alleging the mortgage lender misrepresented and omitted material facts during the origination of plaintiff's loan. Lopez v. Wachovia Mortgage, 10-01645, 2010 WL 2836823 (N.D. Cal. July 19, 2010). The court held plaintiff's claims were not preempted because plaintiff alleged affirmative misrepresentations, stated it was premature to make a final decision on the defense, and suggested a trial might be needed to create a record on the impact of the state rules on defendant's lending activities.

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Majority Rules

As discussed in past Newsletters, courts have split over the application of the two preemption provisions in FCRA. 15 U.S.C. § 1681h(e) permits state tort claims against information furnishers, but imposes a higher burden of proof. Congress later amended FCRA to add 15 U.S.C. § 15t(b)(1)(F), which provides that "[n]o requirement or prohibition" may be imposed under state law concerning the responsibilities of information furnishers. A district court in Kentucky weighed in recently, holding the latter provision preempts both state statutory and common law claims. Lufkin v. Capital One Bank (USA), N.A., 10-CV-18, 2010 WL 2813437 (E.D. Tenn. July 16, 2010). Characterizing this as the "majority approach," the court rejected rulings by other courts attempting to harmonize the two provisions by holding § 1681h(e) concerns common law tort claims and § 1681t(b)(1)(F) concerns state statutory claims.

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FCRA Means What It Says

In Carvalho v. Equifax Information Services, No. 09-15030 (9th Cir. Aug 18, 2010), plaintiff alleged that a furnisher of information to the credit reporting agencies violated section 1785.25(f) of the California Consumer Credit Reporting Agencies Act (CCCRA) by failing to conduct an adequate investigation after she notified the furnisher that she disputed a debt reported to the agencies. The Ninth Circuit held her claim was preempted by FCRA. The court concluded FCRA's exemption of CCCRA section 1785.25(a) from preemption applied only to that section and not to any other sections of the statute.

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This newsletter addresses recent financial services developments. Because of its generality, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

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