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Financial Services Report

Staying Ahead of the Summons

Editor's Note

Maul Street

One story dominated all others this quarter, and no wonder. It was a monster worthy of Godzilla. Like many disasters, it started small. In early Spring, an ominous black slick began seeping out of a hole. It quickly turned into a gigantic black, oozing cloud. By press time, it had become a relentless, brooding gusher. Experts tried in vain to stop it, and could only stand by helplessly. The dark blob threatens to wreak damage the likes of which hasn't been seen in more than a half century. It will be August before anything gets done.

We're talking, of course, about the "Restoring American Financial Stability Act of 2010." Otherwise known as RAFSA.

There's a great deal in the RAFSA that seeks to punish; far less, it seems, to address the causes of the financial crisis or avoid future missteps. To wit: despite fifteen Titles to the Senate bill (see "Fasta RAFSA, or Bongo in the Congo" below), there is not a word about Fannie Mae and Freddie Mac. On the bright side, no pelicans have been harmed in the RAFSA. But give it time. At 1,500 pages and counting, one can't rule out anything.

Treasury Secretary Geithner flew to Europe to lecture the Germans about over-regulation. Days after they restricted short-selling, markets collapsed. He might have saved the flier miles and taken a stroll instead to the other end of Pennsylvania Avenue.

It is not easy writing a quarterly newsletter when events in the Beltway are happening this fast. We're predicting a signed bill by the August recess… in time for the Fall election. RAFSA will mark a profound change for the world of banking and securities, and the economy in general. Some experts predict that the hit from U.S. legislation alone could account for 16% of bank profits by 2013. Such are the seeds from which unintended consequences grow. We plan to send e-mail Alerts and post updates throughout the summer as the House and Senate versions of the bill work their way through the Joint Committee. To stay up to date, you can befriend us at http://www.mofo.com/resources/regulatory-reform.

Until next time, keep your toes and fingers crossed (insert your shaman here), katy bar the bank vault, and have a glorious summer.

William Stern, Editor-in-chief

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MoFo Metrics

4:	Percentage of DNA we share with Neanderthals
82:	Number of no-injury class actions filed again Toyota over sudden acceleration
8:	Number of separate traveler screening lines, Toronto airport
30:	Heart attacks triggered each year by momentary anger, in 1000's
120:	U.S. newspapers shut down in the past 2 years
40:	Average number of herbs and spices in typical American's pantry
2.5:	Pet snakes in America, in millions
7,777:	World record for hugs, 24 hours

Beltway Report

Fasta RAFSA (or, Bongo in the Congo)

Imagine trying to report on Lady Gaga's wardrobe changes and you will have an idea what it's like trying to stay ahead of the financial regulatory reform bill. Dubbed the Restoring American Financial Stability Act of 2010, RAFSA is a work in progress and changes daily. The House and Senate versions of the two bills (H.R. 4173) remain to be reconciled, but whatever emerges, RAFSA will cover a lot of ground. It weighs in at 1,500-plus pages, so unless you plan to read it with someone skilled in the Heimlich it's better to digest it in chunks. That is what we plan to do. Our e-mail Alerts and web postings (at http://www.mofo.com/resources/regulatory-reform) will continue to report on each chunk separately.

Looking at the Senate version, RAFSA includes fifteen Titles: Title I (Financial Stability Council and the FRB's supervision of holding companies); Title II (resolution and liquidations); Title III (reorganization of bank supervising agencies); Title IV (regulation of hedge fund advisers); Title V (Office of National Insurance and state-based insurance reform); Title VI (capital concentration and limits on bank activities, including limits on derivatives); Title VII (regulation of OTC derivatives); Title VIII (payments and clearing); Title IX (investor protection and improved securities disclosures, securities remedies and enforcement, whistleblowers, credit rating agencies, securitizations, say-on-pay and corporate governance issues, SEC improvements); Title X (the proposed Consumer Financial Protection Bureau, and other consumer-related issues such as enforcement powers, preemption, and specific reforms vis-à-vis credit cards, mortgages, data privacy, remittance transfers, and interchange fees); Title XI (Federal Reserve System governance and reforms); and Title XII (access to mainstream financial institutions); and additional titles reducing the TARP authorization, requiring the United States to vote against certain IMF loans to foreign governments, and addressing the trade in minerals from war-torn Congo.

For more information, contact Rick Fischer at lfischer@mofo.com, Oliver Ireland at oireland@mofo.com, or Andrew Smith at asmith@mofo.com.

Treasury Gets Volck-sy

"Volcker" means "folk" in Deutsch. No wonder. The "Volcker Rule" has a populist appeal, and on March 3, Treasury proposed legislative language to the "Volcker Rule" that would limit proprietary trading by banking institutions and limit the overall size of financial companies. It would add sections 13 and 13(a) to the Bank Holding Company Act ("BHCA"). Section 13 would prohibit proprietary trading by insured depository institutions, companies that control them, and companies that are treated as bank holding companies under the BHCA. It would prohibit those companies from sponsoring and investing in hedge funds and private equity funds, but would allow them to continue serving as investment advisers to hedge funds and private equity funds, but they would be prohibited from engaging in covered transactions (as defined in section 23A of the Federal Reserve Act) with, or provide custody, securities lending and other prime brokerage services to, hedge funds or private equity funds. Non-bank financial companies would be allowed to continue to engage in proprietary trading and hedge fund and private equity activities, but if these firms are under the jurisdiction of the Federal Reserve Board ("FRB"), they would be subject to additional capital requirements and quantitative limits.

> DUBBED THE RESTORING AMERICAN FINANCIAL STABILITY ACT OF 2010, RAFSA IS A WORK IN PROGRESS AND CHANGES DAILY. THE HOUSE AND SENATE VERSIONS OF THE TWO BILLS (H.R. 4173) REMAIN TO BE RECONCILED, BUT WHATEVER EMERGES, RAFSA WILL COVER A LOT OF GROUND.

Section 13a would prohibit any financial company from engaging in mergers or acquisitions that would result in the company holding more than 10% of the aggregate consolidated liabilities of all financial companies. At this point, it is not clear that the Administration will succeed in incorporating the Volcker Rule, as proposed, in regulatory reform legislation. The House and Senate bills have already passed, and Senator Dodd has criticized the Administration's efforts as coming late in the legislative process. For a more in-depth discussion of the rule, please see our client alert at http://www.mofo.com/files//Uploads/Images/100305Volker.pdf.

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Dismantling Large Banks—A "How to" Guide

On May 17, the FDIC issued a proposed rule that would require certain insured depository institutions to submit a contingent resolution plan outlining how they could be separated from their parent structures and wound down in an orderly and timely manner. Institutions with assets greater than $10 billion that are subsidiaries of a holding company with total assets of

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"Beltway"

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more than $100 billion would be subject to this proposal. The plan must include a summary analysis of the institution's ability to be resolved in an orderly fashion in the event of its receivership or the insolvency of its parent company or a key affiliate, including the disclosure of any material obstacles to resolution. The plan would require the approval of the institution's board of directors or a designated executive committee, provide a time frame within which remediation efforts may be achieved and be updated at least annually. In addition, an institution would be required to submit its plan within 6 months of the effective date of the rule, and as a penalty for noncompliance, the FDIC could, for example, initiate the process of deposit insurance termination. Comments are due by July 16, 2010.

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

Hold On to the Holder Rule

On March 2, the FTC announced its intention to review its "Holder in Due Course Rule." This rule requires that when a seller provides financing for a customer or refers the customer to a lender, the loan contract must include a notice that allows the consumer to assert claims or defenses against the lender or subsequent holder of the contract. The FTC indicated its intention, in connection with its review of this rule, to request comment on the economic impact of, and continuing need for, the rule, the potential conflict between the rule and other laws or regulations and the effect of any technological, economic or other industry changes on the rule.

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

Animal CRAckers

On March 11, the federal banking agencies issued final changes to the Interagency Questions and Answers Regarding Community Reinvestment ("Q&As") that include one new Q&A and revisions to two existing Q&As. The new Q&A provides examples of how to demonstrate that community development services meet the criteria of serving low- and moderate-income areas and individuals when actual income is not available. The two revised Q&As enable consideration of a pro rata share of mixed income affordable housing projects as community development projects. Separately, the agencies declined to adopt a recommendation that banks receive favorable consideration for providing financial literacy education to primary and secondary school students.

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

Extending the Securitization Safe Harbor

The FDIC voted to extend the safe harbor provided under 12 C.F.R. § 360.6 until September 30, 2010, from the FDIC's ability, as conservator or receiver, to recover assets securitized or participated out by an insured depository institution. When the safe harbor was initially adopted in 2000, the FDIC provided important protections for securitizations and participations by confirming that, in the event of a bank failure, the FDIC would not try to reclaim loans transferred into such transactions so long as an accounting sale had occurred. However, in June 2009, the Financial Accounting Standards Board ("FASB") finalized modifications to the accounting treatment for such transactions. Following the 2009 effective date of these changes, most securitizations no longer meet the off-balance sheet standards for sale accounting treatment, and, as a result, no longer comply with the preconditions for the application of the original FDIC safe harbor. In November 2009, the FDIC approved a transitional safe harbor that permanently grandfathered securitizations or participations in process through March 31, 2010 that previously would have qualified for the safe harbor, but for the changes to the accounting standards. In December 2009, the FDIC sought stakeholder feedback on questions and sample regulatory text regarding the treatment of securitizations and participations issued after March 31, 2010. Given the extensive public comments, the extension of the safe harbor through September 30, 2010 will provide a transitional period for adoption and implementation of final standards for a safe harbor for securitizations.

GIVEN THE EXTENSIVE PUBLIC COMMENTS, THE EXTENSION OF THE SAFE HARBOR THROUGH SEPTEMBER 30, 2010 WILL PROVIDE A TRANSITIONAL PERIOD FOR ADOPTION AND IMPLEMENTATION OF FINAL STANDARDS FOR A SAFE HARBOR FOR SECURITIZATIONS.

For more information, contact Obrea Poindexter at opoindexter@mofo.com or Ken Kohler at kkohler@mofo.com.

Care and Treatment of Credit Union Directors

On March 18, the National Credit Union Administration ("NCUA") issued a proposed rule that would provide standards for federal credit union directors concerning their duties in managing the affairs of the credit union. The proposed rule specifies the duties of care and loyalty of a director, states that a director must understand how to evaluate the credit union's financials and provides guidance on when a director may properly rely on management and other third parties. In addition, credit union

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"Beltway"

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directors would be required to act in the best interests of credit union members, carry out their duties in good faith and with care, including reasonable inquiry, and administer the affairs of the credit union fairly and impartially and without discrimination in favor of or against any particular member. Moreover, directors would be prohibited from indemnifying officials or employees for liability for misconduct that is grossly negligent, reckless or willful in connection with a decision affecting the fundamental rights of a credit union's members. The comment period has closed.

For more information, contact Rick Fischer at lfischer@mofo.com or Oliver Ireland at oireland@mofo.com.

Risk-Sensitive Deposit Insurance Assessment Framework

On April 13, the FDIC issued a proposed rule to revise the deposit insurance assessment system for large institutions, which pose unique and concentrated risks to the Deposit Insurance Fund. Under the proposal, risk categories and long-term debt ratings would no longer be used. The FDIC, however, would continue to use the supervisory ratings as a factor in measuring risk. The FDIC would replace the financial ratios currently used with a scorecard consisting of financial measures that the FDIC believes are more forward looking and better suited for large institutions. The proposal also includes questions about how to incorporate other risk measures, like the quality of underwriting or risk management practices, in the future. The proposal would create two scorecards—one for large institutions and the other for highly complex institutions. A highly complex institution would be defined as an insured depository institution with greater than $50 billion in total assets that is fully owned by a parent company with more than $500 billion in total assets. The designation would also apply to a processing bank and trust company with greater than $10 billion in total assets. Each scorecard would have two components—a performance score and a loss severity score—that are of particular interest to the FDIC as an insurer. The two scores would be combined to produce a total score, which would be translated into an initial assessment rate. Similar to the current system, the FDIC would retain an ability to make limited discretionary adjustments. The proposal would also alter the assessment rates applicable to all insured depository institutions to ensure that the revenue collected under the proposed assessment system would approximately equal that under the existing assessment system.

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

Reg D and Term Deposits

On April 30, the FRB issued a final rule amending Regulation D to authorize the Federal Reserve Banks to offer term deposits. The final rule did not adopt a sunset provision for amendments to Regulation D, allowed term deposits to be used "as needed based on monetary policy objectives," changed the definition of "short term interest rates" to make it more consistent with market practices, clarified that it may condition the early withdrawal of term deposits and pledging term deposits as collateral and clarified that term deposits may not be used for general payments or settlement activities. The Final Rule will take effect 30 days after publication in the Federal Register.

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

Feds Release BS and Money Laundering Manual

On April 29, the Federal Financial Institutions Examination Council ("FFIEC") released a revised Bank Secrecy Act/ Anti-Money Laundering ("BSA/AML") Examination Manual. If you were expecting a "How to" Guide, it's not. The 2010 version further clarifies supervisory expectations since the last update in 2007. The revisions again draw upon comments from the banking industry and examination staff. The manual is located on the FFIEC BSA/AML InfoBase at http://www.ffiec.gov/bsa_aml_infobase/default.htm. Banks and credit unions may direct questions about the manual to their primary federal regulator.

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

Policy Statement on Funding and Liquidity Risk Management

On March 16, the federal banking agencies, in conjunction with the Conference of State Bank Supervisors, released a policy statement on their expectations for sound funding and liquidity risk management practices. The policy statement summarizes the principles of sound liquidity risk management issued previously and, where appropriate, supplements them with the "Principles for Sound Liquidity Risk Management and Supervision" issued in September 2008 by the Basel Committee on Banking Supervision. Given the recent market turmoil, the agencies are reiterating the importance of effective liquidity risk management for the safety and soundness of financial institutions. This policy statement emphasizes the importance of cash flow projections, diversified funding sources, stress testing, a cushion of liquid assets and a formal, well-developed contingency funding plan as primary tools for measuring and managing liquidity risk. The agencies expect each financial institution to manage funding and liquidity risk using processes and systems that are commensurate with the institution's complexity, risk profile and scope of operations.

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

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Operations Report

The Operations Report this quarter focuses on the various government and extra-government efforts to beef up bank reserves, solvency, and asset liquidity.

Banking Guidance on Correspondent Concentration Risk

On April 30, the federal banking agencies issued guidance on correspondent concentration risk. According to the agencies, this guidance is intended to promote prudent risk management practices among financial institutions. The guidance outlines the expectations of the agencies for identifying, monitoring and managing correspondent risks between financial institutions, as well as for performing appropriate due diligence on all credit exposures to, and funding transactions with, other financial institutions. The guidance supplements, rather than supersedes, prior guidance and became effective on May 4. For additional information, please see our client alert at http://www.mofo.com//files//Uploads/Images/100505Risks.pdf.

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Mark-to-Market Plan Portends Seismic Shift

In ordinary quarters, this item would be worth blogging home about. This quarter, it risks getting lost in the RAFSA commotion.

On May 27, the FASB wants to vastly expand the use of mark-to-market accounting. In a draft ruling posted on its Web site, the FASB proposed that banks value unfunded loan commitments and loans they plan to hold to maturity in the same way they currently value loans they intend to sell. The rule would also change the way deposits are valued. If approved, the new rule could alter the banking landscape.

The public comment period ends September 30. Public roundtables will be held in October. Once the comments are in, the FASB will deliberate again before releasing any final rule changes.

Basel III

The job of ensuring that banks carry bigger safety buffers of capital and liquid assets is getting outsourced to the Basel Club of regulators, a/k/a the Basel Committee on Banking Supervision, which aims to finalize its proposals by year's end and to implement them by the end of 2012. The Basel Club has not articulated how big the buffers should be, but the banks' main lobbying arm, the Institute of International Finance, will release a report on June 10 that many expect will give a dire picture of the economic costs of Basel III. At the moment, some private analysts estimate that the hit from U.S. legislation alone could depress bank profits by 16% or more.

Recently, the Basel Club issued proposed updated principles concerning sound corporate governance of banking organizations. The proposed principles reflect lessons learned during the recent financial crisis, which, according to the Basel Club, "highlighted the continued importance of sound corporate governance" for banks. The proposed principles address, among other things: (1) the role of a bank's board of directors in overseeing the bank's risk management strategy; (2) the qualifications of directors; (3) the importance of a well-developed and independent risk management function, including a chief risk officer with sufficient stature, authority, independence, resources and access to the board to perform her job effectively; (4) board oversight of compensation systems; and (5) the role played by bank regulators in evaluating bank corporate governance practices. Comments are due by June 15, 2010.

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

Acquiring Failure

On April 23, the FDIC published additional Q&As on the Statement of Policy on Qualifications for Failed Bank Acquisitions ("Policy Statement") issued in September 2009. The Q&As clarify that there is no requirement that investors must have held their ownership for a specific amount of time. The FDIC will take into consideration whether a significant portion of the shares (total equity or voting equity) held by the investors in the holding company pre-dating the proposed acquisition of the failed bank was recently acquired or was part of a recapitalization of the existing institution. The Q&As also state that recapitalizations of existing institutions are not subject to the Policy Statement. In addition, the Q&As state that at least one-third of the investors must be investors who are bound by the terms of the Policy Statement (the so-called "anchor group"). An investor who has the right to designate a board member is automatically subject to the Policy Statement, even if such investor holds 5% or less of the total voting equity shares of the institution. An investor having a right of first refusal to acquire another shareholder's shares at the same price and on the same terms will not be subject to the Policy Statement as long as the execution of such right would not result in the ownership of more than 5% of the voting equity shares of the institution. Investors holding 5% or less of the voting equity are not subject to the detailed questionnaires required by the Policy Statement, as long as they are not part of the anchor group. However, de minimis investors must be included in the List of Investors provided to the FDIC.

For more information, contact Oliver Ireland at oireland@mofo.com.

Plastic (a/k/a CARD REPORT)

New FRB Credit Card Proposal

On March 15, the FRB issued a proposed rule that would require a complete transformation of the existing penalty fee structure for the entire credit card industry. As a result, issuers may yet again be required to review and restructure credit card portfolios, underwriting criteria and credit models. The rule is intended to require a card issuer to only impose penalty fees that are reasonable and proportional to the violation. While the proposed rule purports to implement the CARD Act provision prohibiting an issuer from imposing a penalty fee or charge in connection with a violation of a credit card agreement, the proposed rule goes well beyond the statute and would effectively establish price controls and, in many cases, the specific prices for penalty fees. Specifically, the proposed rule would place limitations on penalty fees that a credit card issuer may assess. An issuer could only charge a penalty fee if the fee represents a "reasonable proportion" of the costs incurred due to that type of violation or charge a penalty fee for a violation if the issuer has determined that the amount of the fee is "reasonably necessary" to deter that violation, using an empirically derived and statistically sound model. The proposed rule represents the third stage of the FRB's implementation of the CARD Act, which was enacted in May 2009. The provisions of the CARD Act addressed in this proposal will go into effect on August 22, 2010. A final rule is expected in mid-June 2010.

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Resolving Billing Disputes

On May 19, the Ninth Circuit issued an opinion regarding who a credit card issuer is obliged to resolve billing disputes with on a credit card account. *Edwards v. Wells Fargo*, No. 06-16892 (May 19, 2010). The plaintiff, an individual who was an authorized user on a credit card account but not personally liable for any charges on the account, alleged that the defendant bank violated Regulation Z because it would not respond to any of his disputes for charges that he had made on the account. The Ninth Circuit repeatedly indicated that the FRB had seemingly confused the issue because of its drafting in Regulation Z—an issue that the court noted was clear under the statute. Specifically, the statute indicates that the billing dispute resolution obligation is owed to an "obligor" on a credit card account, but Regulation Z indicates that the duty is owed to a "consumer." The court, following the statutory language, concluded that a credit card issuer's billing dispute obligation under Regulation Z is owed only to an obligor on a credit card account.

For more information, contact Oliver Ireland at oireland@mofo.com.

Re-Gifting the Gift Card Rule

More regulation for the payment card industry is on the way. On April 1, the FRB published amendments to Regulation E implementing the gift card provisions of the CARD Act, which become effective on August 22, 2010. The rule establishes requirements for both general use prepaid cards and store gift cards, as well as for gift certificates. Consistent with the CARD Act, the rule excludes certain products from the definitions of general-use prepaid card, store gift card and gift certificate, including, most importantly, reloadable cards that are not marketed as gift cards. An excluded product is not subject to the substantive restrictions regarding when a dormancy, inactivity or service fee may be imposed or the use of expiration dates. If an exclusion is not available, these restrictions apply. Specifically, the rule prohibits the imposition of a dormancy, inactivity or service fee in connection with a gift card or gift certificate, unless an issuer meets certain prescribed requirements, including the imposition of a fee only if there has been no activity for at least one year from the issuance, last reload, or use of the card or certificate. In addition, the rule provides that no person may sell or issue a general-use prepaid card, a store gift card, or a gift certificate with an expiration date, unless specific requirements are met, including a requirement that the underlying funds do not expire for at least five years. For additional information, please see our client alert at http://www.mofo.com//files//Uploads/Images/100407GiftCard.pdf.

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OD'ing on ODs

In November 2009, the FRB published a final rule prohibiting an institution from charging an overdraft fee for ATM and one-time debit card transactions, unless the institution obtains affirmative consent and opt-in and gives written notice. An institution must provide the consumer with a written or electronic opt-in notice segregated from other information, provide a reasonable opportunity to opt in, obtain an affirmative opt in and provide the consumer with written confirmation of the opt in and a statement of the consumer's right to revoke. The rule will become effective on July 1.

On May 28, the FRB issued a final clarification that the overdraft prohibition applies to all institutions, even an institution that has a policy of declining authorization. That means that, notwithstanding the absence of the consumer's opt in, an institution may pay overdrafts so long as an overdraft fee is not imposed for doing so. Some issuers have already announced that they will no longer charge overdraft fees. Furthermore, on April 29, the OTS issued proposed overdraft guidance limiting aggregate overdraft fees and requiring new overdraft disclosures.

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Mortgage Report

HAMPered By Litigation

A wave of putative class actions on home loan modifications is building. Cases have been filed on the East and West coasts. At the moment, two contract theories are most prominent. First, plaintiffs allege that they have standing to sue lenders for not making modifications under the Home Affordable Modification Program ("HAMP") and for not abiding by the Treasury Department's guidelines, because plaintiffs are third party beneficiaries under the servicer participation agreements. Second, plaintiffs allege that the form trial payment plan ("TTP") itself is a contract requiring lenders to automatically convert to a permanent loan modification so long as borrowers make three qualifying loan payments and submit the required paperwork. But, if valid, the TTP theory would eliminate the lenders' use of borrower income verification, the Net Present Value test and the 31% cap on net monthly income to mortgage expenses, all of which are contrary to the basic elements of HAMP. A secondary theory of liability involves a due process challenge with claims alleging that lenders failed to provide borrowers with written adverse action notices and an appeals process after the denial of a HAMP loan modification.

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

HMDA Hearings

The FRB announced that it would hold four public hearings, beginning in July, on potential revisions to Regulation C, which implements the Home Mortgage Disclosure Act. The hearings will serve three objectives. First, the FRB will gather information to evaluate whether the 2002 revisions to Regulation C, which required lenders to report mortgage pricing data, helped provide useful and accurate information about the mortgage market. Second, the hearings will provide information that will help the FRB assess the need for additional data and other improvements. Finally, the hearings will help identify emerging issues in the mortgage market that may warrant additional research. The hearings will take place at the Federal Reserve Bank of Atlanta on July 15, the Federal Reserve Bank of San Francisco on August 5, the Federal Reserve Bank of Chicago on September 16, and the FRB in Washington, D.C. on September 24. All hearings will include panel discussions by invited speakers. Other interested parties may deliver oral statements of five minutes or less during an "open-mike" period. Written statements of any length may be submitted for the record.

For more information, contact Obrea Poindexter at opoindexter@mofo.com or Andrew Smith at asmith@mofo.com.

RAFSA Waves Goodbye to YSPs and Prepayment Penalties

The financial reform legislation passed on May 20 by the U.S. Senate contains an amendment to address certain mortgage lending practices. The Merkley-Klobuchar amendment, which was approved on May 13, would end prepayment penalties and yield-spread premiums. It effectively bans yield-spread premiums by prohibiting brokers or any loan originator from compensation that varies based on any term of the loan except the principal amount.

The amendment would also require lenders to ensure a borrower's ability to repay a mortgage for five years based on verifiable income documentation. Lenders are presumed to have properly underwritten loans if they followed that requirement and if each loan's total points and fees do not exceed 3% of the loan amount. Borrowers could sue if total points and fees exceed that level. Lenders could be liable for actual damages and enhanced damages, which appear to bear no relationship to actual harm. Regulations implementing this provision would be left to a proposed consumer protection bureau to write and enforce. The Merkley-Klobuchar amendment moves the Senate bill closer to the House bill, which contains measures for sweeping new mortgage standards, including banning prepayment penalties and requiring a minimum debt-to-income ratio.

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

RESPA Overcharges Dead in the Ninth Circuit

On March 9, the Ninth Circuit affirmed the dismissal of Real Estate Settlement Procedures Act ("RESPA") claims alleging that section 8(b)'s prohibition against "unearned fees" reached Wells Fargo's overcharging for excessive underwriting and tax services fees. *Martinez v. Wells Fargo Home Mortgage, Inc*., 598 F.3d 549 (9th Cir. 2010). The Ninth Circuit concluded that the clear and unambiguous statutory language of RESPA section 8(b) does not reach the practice of "overcharging." It also concluded that the plaintiffs' claims under California's Unfair Competition Law ("UCL") were not viable. The Ninth Circuit affirmed dismissal of the three UCL claims because the claims alleging "unfair" and "fraudulent" conduct are preempted by regulations implementing the National Bank Act, and the allegations of "illegal" conduct fail to state a claim.

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

A Silver Lining for Captive Reinsurance Losses

A small set of putative class actions filed in 2007 alleged that a lender's captive mortgage reinsurance violated RESPA because the reinsurance arrangement was a sham. Plaintiffs alleged that no actual reinsurance existed where no actual claims have been paid. Now that losses to captive reinsurers are catastrophic, federal courts are itching to clear their loaded case dockets of these actions (read: silver lining for reinsurance losses). Plaintiffs' lawyers are scrambling for new theories of liability.

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

Privacy Report

Don't Forget the FCRA Risk-Based Pricing Rule

In less turbulent times, the FCRA risk-based pricing rule would be a big deal, and a newsletter like ours might have even led with it. Not this year.

As we also previously reported, the FRB and FTC issued a new risk-based pricing rule in January that requires any company that uses a credit report or score in connection with a credit decision (including companies such as banks, mortgage bankers, auto lenders, retailers, and public utilities) to send notice to a consumer when, based on a credit report or score, the company grants credit on "material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers." *See* 12 C.F.R. Pt. 222, 16 C.F.R pt. 640. The underlying statutory provision of the Fair Credit Reporting Act ("FCRA") (15 U.S.C. § 1681m(h)) was intended to require lenders to notify consumers when the lenders charged consumers more for credit based on the consumers' credit reports. The requirement was motivated by a concern that, because consumers are entitled to "adverse action" notices under the FCRA only when they are denied credit (or do not accept a counteroffer for credit), consumers are not adequately apprised of the effect of credit reports on the pricing of credit. The agencies have provided model form notices that provide a "safe harbor" for compliance. Compliance with the rule is required by January 1, 2011. For a detailed discussion of the New Risk-Based Pricing Rule's provisions, please see our client alert at http://www.mofo.com//files//Uploads/Images/100402Pricing.pdf.

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

FCC Proposal Could Limit Service and Collections Calls to Cell Phones

A Federal Communications Commission ("FCC") proposed rule would limit the ability of banks, lenders, utilities, debt collectors and others to make calls to their customers' cell phones. These new restrictions would apply to *any* call to a cell phone, including calls to collect a debt, notify a customer of a payment due or request additional information to complete an application. The proposal, if made final, would undo an FCC interpretation permitting calls to cell phones where the cell phone number is provided "to a creditor, e.g., as part of a credit application," and could expose creditors and collectors to private liability and statutory damages under the Telephone Consumer Protection Act. The comment period has closed. For more information, please see our client alert at http://www.mofo.com//files//Uploads/Images/100322Cell.pdf.

For more information, contact Andrew Smith at asmith@mofo.com, Julie O'Neill at joneill@mofo.com, or James McGuire at jmcguire@mofo.com.

Fill in the Blanks

The federal banking agencies, NCUA, SEC, CFTC and FTC jointly released an online utility for generating privacy notices. This Online Form Builder is based on the model form regulation, published in December 2009, under the Gramm-Leach-Bliley Act. The instructions for the form builder will guide an institution to select the version of the model form that fits its practices, such as whether the institution provides an opt-out for consumers. To obtain a legal "safe harbor" provided for appropriate use of the model form, institutions must follow the instructions in the model form regulation when using the Online Form Builder. The Online Form Builder is available at http://www.federalreserve.gov/bankinforeg/privacy_notice_instructions.pdf.

For more information, contact Andrew Smith at asmith@mofo.com, Obrea Poindexter at opoindexter@mofo.com, or Nathan Taylor at ndtaylor@mofo.com.

Merchant Emptor

On March 22, Washington became the second state (in addition to Minnesota) to enact legislation imposing liability on merchants for breaches involving payment card information. Wash. H.B. 1149. The Washington law, which will be effective on July 1, provides that if a "processor" or "business" fails to take reasonable care to guard against unauthorized access to sensitive payment card data and such failure is the "proximate cause" of a breach involving that data, the processor or business is liable to a financial institution for reimbursement of costs related to the reissuance of credit cards and debit cards that are incurred by the financial institution to mitigate damages to its card holders that are residents of Washington. Other than payment card processors and vendors, this breach liability only applies to businesses that process more than six million credit card and debit card transactions annually and that provide, offer or sell goods or

THESE NEW RESTRICTIONS WOULD APPLY TO ANY CALL TO A CELL PHONE, INCLUDING CALLS TO COLLECT A DEBT, NOTIFY A CUSTOMER OF A PAYMENT DUE OR REQUEST ADDITIONAL INFORMATION TO COMPLETE AN APPLICATION.

(Continued on Page 9)

"Privacy"

(Continued from Page 8)

services to Washington residents. The Washington law provides two important exemptions from liability for businesses. A business would not be liable for a breach involving payment card information if: (1) the information was encrypted at the time of the breach; and (2) the business "was certified compliant" with the PCI data security standards at the time of the breach." A business will be considered compliant if its PCI compliance "was validated by an annual security assessment" that took place no more than one year prior to the breach.

For more information, contact Nathan Taylor at ndtaylor@mofo.com.

FCRA Furnisher Deadline Soon

As we previously reported, in 2009, the federal banking agencies, NCUA and FTC issued joint rules to implement FACT Act requirements for persons who furnish information to consumer reporting agencies. These rules will become effective on July 1, 2010. The new rules will impose two separate, but related, duties on furnishers. First, a furnisher will be required to implement written policies and procedures regarding the accuracy and integrity of information it furnishes to consumer reporting agencies. In addition, a furnisher will be required to investigate disputes submitted directly to the furnisher by the consumer regarding the accuracy of information in consumer reports relating to accounts that the consumer has with the furnisher.

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Arbitration Report

Who Decides Enforceability?

An en banc panel of the Third Circuit recently held that "an unconscionability challenge to the provisions of an arbitration agreement is a question of arbitrability that is presumptively for the court, not the arbitrator, to decide." *Puleo v. Chase Bank USA, N.A.*, No. 08-3837, 2010 U.S. App. LEXIS 9497 (3d Cir. May 10, 2010). The plaintiffs brought a putative class action challenging default rate increases on the account balances of their Chase credit cards. The Chase Cardmember Agreement contained an Arbitration Agreement expressly barring class actions, which the plaintiffs argued was unconscionable. After Chase moved to compel arbitration, the plaintiffs urged the district court to order the parties to arbitrate their class claims, notwithstanding the Agreement's ban on class actions, but argued that the question of whether the class action waiver was unconscionable was a question for the arbitrator, not the court. The district court rejected their arguments, concluding the plaintiffs' challenge to the enforceability of the class action waiver was a question of arbitrability for the court to decide and that the Arbitration Agreement was enforceable. On appeal, the plaintiffs challenged only the first of these conclusions, which the Third Circuit affirmed in a 6-4 decision.

For more information, contact Bob Stern at rstern@mofo.com or Nancy Thomas at nthomas@mofo.com, who represent Chase in this case.

New Life For Consumer Arbitration

Consumer arbitration has been an important tool for controlling class action exposure, at least until the states began to fiddle and find waivers of class action clauses unconscionable. The U.S. Supreme Court has turned its focus on class action waivers and may be primed to rule that the Federal Arbitration Act preempts state laws that preclude the enforceability of class action waivers.

On April 27, 2010, in a 5-3 decision, the U.S. Supreme Court held that the Federal Arbitration Act does not allow class arbitrations absent an agreement between the parties in their arbitration clauses. *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, No. 08-1198 (U.S. Apr. 27, 2010). The Court held that parties must individually arbitrate a dispute when an arbitration agreement is silent on the issue: "[A] party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so."

On May 3, 2010, the Court vacated and remanded for further consideration in light of *Stolt-Nielsen*, a decision by the Second Circuit that held that a class action waiver was unenforceable. *American Express Co. v. Italian Colors Rest.*, No. 08-1473, 2010 U.S. Lexis 3744 (U.S. May 3, 2010). In *American Express*, the Second Circuit considered evidence demonstrating that the size of the recovery received by any individual plaintiff would be too small to justify the expenses of bringing an individual action, and held that enforcing the class action waiver would thus grant American Express de facto immunity from liability. On remand, the Second Circuit is tasked with considering *Stolt-Nielsen*'s ruling that express consent is required before class arbitration can be imposed. Given that the American Express arbitration agreement expressly excludes class arbitration, it is certainly possible that the Second Circuit will find that no class arbitration can be imposed.

On May 24, 2010, the Supreme Court granted cert in *AT&T Mobility, LLC v. Conception*, No. 09-893, in which it will consider whether the Federal Arbitration Act preempts states from conditioning the enforcement of an arbitration agreement on the availability of class-wide arbitration when class-wide arbitration is not necessary to ensure that the parties to the arbitration agreement are able to vindicate their claims.

Feeling hopeful about the future enforceability of class action waivers? Stay tuned.

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

Preemption Report

The Sound of "Other Shoe" Dropping

Both the Senate and House versions of RAFSA codify the Barnett Bank preemption standard, but may limit the ability of bank regulators to preempt state laws by broad rules such as the express preemption regulations promulgated by the OCC and the OTS. The bill authorizes state attorneys general to file individual actions against national banks and federal thrifts to enforce regulations issued by the new Bureau of Consumer Financial Protection, but does not authorize the filing of class actions. In addition, like the House version, the Senate bill would repeal Watters, eliminating preemption of state laws as applied to operating subsidiaries of national banks and federal thrifts and codify Cuomo, giving state attorneys visitorial powers over these financial institutions.

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You Can Go Your Own Way

A California Court of Appeal might have been humming the Fleetwood Mac song when it told the Ninth Circuit "no" on preemption. A California statute (Civ. Code § 1748.9) requires credit card issuers who offer "convenience checks" to make certain disclosures that differ from what the OCC regulations require. In *Rose v. Chase*, 513 F.3d 1032 (9th Cir. 2008), the Ninth Circuit found Section 1748.9 preempted. But on May 12, a state appellate court in *Parks v. MBNA*, 2010 Cal. App. LEXIS 671 (May 12, 2010) begged to differ. So, national banks either have to make the state-mandated disclosures or not—depending on whether a future plaintiff sues them in state or federal court. Go figure.

For more information, contact Nancy Thomas at nthomas@mofo.com.

Cart First, Then Horse

A federal court in Miami presiding over a multi-district litigation involving many major national banks held that it was premature to determine whether state law challenges to national banks' overdraft fee practices are preempted by OCC regulations. *In re Checking Account Overdraft Litigation*, 2010 U.S. Dist. LEXIS 22761 (S.D. Fla. Mar. 11, 2010). The court did not analyze whether the plaintiffs' state law claims challenging the ordering of debit card and ATM transactions were expressly preempted by 12 C.F.R. § 7.4007(b)(2), and instead found the provision's savings clause, 12 C.F.R. § 7.4007(c), applied. The court's analysis indicates it applied a conflict preemption standard, rather than considering whether the challenged claims were expressly preempted by the regulations.

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THE COURT'S ANALYSIS INDICATES IT APPLIED A CONFLICT PREEMPTION STANDARD, RATHER THAN CONSIDERING WHETHER THE CHALLENGED CLAIMS WERE EXPRESSLY PREEMPTED BY THE REGULATIONS.

Exception that Proves Rule

To end on a brighter note, the Ninth Circuit held claims that a national bank violated the California Unfair Competition Law by overcharging for certain fees and failing to disclose the actual costs of certain services in connection with plaintiff's mortgage were preempted by the National Bank Act and OCC regulations. *Martinez v. Wells Fargo Home Mortgage, Inc.*, 598 F.3d 549 (9th Cir. 2010). The court found these claims were preempted by OCC regulations providing that establishment of fees and the methodology for calculating those fees are business decisions to be made by national banks and expressly preempting state law claims regarding disclosures, as well as origination and processing of mortgages. Interestingly, a Washington district court reached precisely the opposite conclusion in a decision issued the same day as *Martinez*. *Deming v. First Franklin*, 2010 U.S. Dist. LEXIS 32856 (W.D. Wash. March 9, 2010).

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