

M E M O R A N D U M

To: Mortgage Bankers Association

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Re: FACTA Summary

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Fair and Accurate Credit Transactions Act of 2003

The Fair and Accurate Credit Transactions Act of 2003 (“FACTA”), signed into law on December 4, 2003, affects the mortgage industry in many ways. The following describes the major requirements under FACTA and reflects final rules that have been issued by various agencies.

Highlights of the major requirements are as follows:

A. Risk Based Pricing. FACTA requires a new “risk-based pricing” notice that must be provided at application or when a lender uses a consumer report in connection with an offer of credit on terms that are “materially less favorable” than those offered to other consumers. Existing adverse action requirements under both FCRA and the Equal Credit Opportunity Act (“ECOA”) remain in effect.

B. Credit Score Disclosure. After pulling a consumer’s credit score, brokers and lenders will have to provide that score, and the key factors underlying the score, to the consumer. Consumers may also access their score at a consumer reporting agency (“CRA”).

C. Affiliate Marketing. FCRA currently requires a company (Company A) to give consumers the opportunity to “opt-out” before Company A shares “consumer report” information with its affiliate, Company B. Consumer report information includes information from credit reports or financial data from the consumer’s application, but

does not include information about Company A's experience with the consumer. FACTA imposes no further restriction on the sharing of information, but generally requires that, before Company B uses any shared consumer financial information for marketing, it offer the consumer an opportunity to opt-out of such marketing.

D. Medical Information. FACTA introduces new limits on the use and sharing of medical information that could make it difficult for lenders to evaluate whether an applicant has the mental capacity to enter into a loan agreement.

E. Identity Theft. FACTA creates new procedures aimed at curbing identity theft that allow consumers to place an "alert" in their credit file. Lenders must follow special identification procedures before extending credit if the credit report includes an alert.

F. Furnisher Obligations. FACTA creates a more stringent standard for the accuracy of information that lenders furnish to CRAs and allows federal regulators to define circumstances under which a consumer can dispute information being reported to CRAs directly with the lender.

Preemption: While imposing these new requirements, FACTA provides an important benefit for the mortgage industry – it permanently prevents the states from imposing their own more onerous regulations in many areas, including any state regulation related to sharing of information among affiliates. The preemption provisions in the previous version of FCRA had been scheduled to expire on December 31, 2003, meaning that the states could have begun to enact more extensive regulation of CRAs and lenders and other users of consumer reports.

Regulatory Action: FACTA requires that many of its new provisions and revisions to existing law be implemented through regulations issued by various federal agencies. Most significantly for the mortgage industry, the new risk-based pricing notice is to be implemented through a joint regulation issued by the Federal Reserve Board ("FRB") and Federal Trade Commission ("FTC"). MBA has organized an industry-wide coalition to seek a workable regulation. The FRB and FTC have not yet proposed regulations.

FACTA delegated to the FRB and FTC the power to set the effective dates for many of its provisions. Those agencies issued a final rule in February 2004 that sets December 1, 2004, as the effective date for most FACTA provisions. A few provisions that do not require implementing regulations and that the FRB and FTC believe do not create operational difficulties for industry went into effect on March 31, 2004. The risk-based pricing provision is among those that were scheduled to go into effect on December 1, 2004 but these regulations have not been issued as of the date of this memorandum. The agencies have informally

indicated that that provision, as well as other provisions for which regulations have not been issued by the deadline, will not be enforced until final rules are issued, but industry, including MBA, is seeking a more formal pronouncement to that effect.

Summary of the FACTA Provisions

The following summary reflects both the statutory requirements and the status of provisions to be implemented by regulation, with an emphasis on the provisions that particularly affect the mortgage industry.

A. Risk-Based Pricing Notice

FACTA requires a new “risk-based pricing” notice that must be provided at application or when a lender uses a consumer report in connection with an offer of credit on terms that are materially less favorable than those offered to other consumers. The FTC and the FRB are charged with writing regulations to implement this provision.

MBA is concerned that these provisions be implemented in an efficient manner that best serves the interests of consumers. There is considerable difficulty in determining when a customer receives materially less favorable terms which might trigger the notice requirement. Moreover, it is questionable, if it could be determined, whether such a disclosure given at that time would be useful. MBA has organized an *ad hoc* coalition of national trade associations to promote a regulation that would allow lenders to provide a notice at the beginning of the transaction to all customers, explaining that credit reports may affect pricing and the other terms offered to the consumer. This would give consumers the opportunity to correct any errors in their report while at the same time allowing lenders to comply in an efficient manner.

Key features of the Risk-Based Pricing provision in FACTA include:

1. This new notice is required in situations in which a consumer may be offered “sub-optimal” credit terms based on information in a consumer report. It applies to a person that – (1) uses a credit report, (2) in connection with an application for or grant or extension of credit, (3) on “material terms that are materially less favorable than the most favorable terms available” to a “substantial portion” of that creditor’s other customers.
2. The notice must identify the CRA that provided the information and explain that the information affected the terms of the offer. The risk-based pricing notice may be provided orally, electronically (without regard to federal ESIGN law or other consent provisions), or in writing. If the lender provides a notice of adverse action, no RBP notice is required, but the RBP notice does not replace the adverse action notice.

3. The timing of the notice is very significant. The general rule of the statute is that the notice may be provided at application, communication of an offer of credit, or when the credit is granted. This should allow lenders to provide a generic notice to all applicants at the time of application. But some consumer advocates have urged the FTC and FRB to require a “triggered” notice, informing consumers at the time they are granted credit that they are receiving credit on terms that are materially less favorable than the terms offered to other consumers served by the lender.
4. Although the risk-based pricing requirement was scheduled to go into effect on December 1, 2004, as noted above, the regulators have yet to propose regulations. They have indicated that this provision will not be enforced until final rules are issued. However, the MBA is urging that the agencies issue formal written guidance making this point explicit.

No Private Right of Action

1. The risk-based pricing provision provides that the private and state enforcement provisions do not apply to this provision. It is to be enforced exclusively by the FTC and other federal agencies.
2. All but one of more than a dozen district court cases have held that FACTA also repealed the private right of action for any violation of Section 615 of FCRA, which also contains the FCRA adverse action provision as well as disclosures for prescreened credit offers. The U.S. Court of Appeals for the Seventh Circuit also noted in judicial *dicta* that the private right of action under Section 615 was repealed.
3. Most of those courts have held that the repeal does not apply if the events took place before the risk-based pricing notice provision went into effect on December 1, 2004; *i.e.*, consumers may still maintain an action. Others have held that the action had to be filed before that date to be maintained.

B. Credit Score Disclosure

FACTA requires a person who uses a credit score to make or arrange credit secured by one to four units of residential real property – *i.e.*, a mortgage lender or mortgage broker – to give the consumer credit scoring information obtained from the CRA, an explanation of the role of credit scores in the lenders’ decisions, and the name of the CRA. CRAs must disclose similar information at the consumer’s request and may charge a reasonable fee for doing so. This provision is based on a very similar California requirement that has been in effect since 2001.

The credit score disclosure provided by either mortgage users or CRAs must include:

1. The four key factors that adversely affected the score, listed in order of importance. If the number of inquiries was a key factor (*i.e.*, it adversely affected the score), a consumer reporting agency must also provide a clear and conspicuous statement that the number of inquiries was a factor, even if it was not in the top four.
2. The date the score was created.
3. Name of the person that provided the credit score or credit file on which it was based.
4. Range of possible scores.
5. A lender or broker need not provide an explanation of the scores beyond the form disclosure provided in the statute.
 - This provision distinguishes between “credit scores,” which are based solely on credit information, and “mortgage scores” produced by an automated underwriting system used in the mortgage process that considers factors in addition to credit information, such as loan-to-value ratio or the consumer’s financial assets. A mortgage score need not be disclosed to the consumer.

This provision does not require regulations. As discussed below, it became effective on December 1, 2004.

C. Affiliate Sharing

FACTA added new restrictions on the use of affiliate information that will have a significant impact on mortgage lenders. Under the new provision, consumers must be given an opportunity to opt out of the *use* for marketing by a company of any financial information obtained from an affiliate, including both consumer reports and direct transaction-and-experience information. Sharing of transaction-and-experience information, as opposed to use of that information by the recipient, is not restricted by this provision.

The existing affiliate-sharing provisions of FCRA allow companies to share identification and transaction-and-experience information with affiliates under all circumstances. They may share “consumer report” information only if the consumer is first given notice and the opportunity to “opt-out” of affiliate sharing. “Consumer report” information includes both information obtained from CRAs and other information bearing on creditworthiness, insurability, etc., such as information obtained from the application or directly from other lenders.

Under the statute, the new FACTA notice allowing the consumer to opt-out of the use of information from affiliates:

1. Must be clear and conspicuous.
2. Must allow the consumer to prohibit all marketing solicitations.
3. May also allow partial opt-outs from different types of solicitations.

In addition:

- Combination with other disclosure. The opt-out notice may be combined with other required disclosures, such as the privacy and opt-out notice under the Gramm-Leach-Bliley Act or the existing affiliate-sharing opt-out under FCRA.
- The opt-out is effective for five years. After five years, if the company wishes to resume affiliate solicitations, the consumer must receive another opt-out notice.
- Preexisting Relationship. The opt-out notice requirement does not apply to an affiliate that wishes to use the information if the affiliate has a “preexisting relationship” with the consumer. A preexisting relationship exists when:
 - The affiliate or the affiliate’s licensed agent has an ongoing financial contract with the consumer;
 - Within the last 18 months, the consumer has purchased, rented, or leased goods or services, or a financial transaction (including holding an active account or policy) has occurred, within the 18 months before the consumer is sent a solicitation; or
 - Within the previous 3 months, the consumer has made an inquiry or application to the affiliate regarding the affiliate’s products or services.

N.B. The periods defining a “preexisting relationship” are the same as those in the FTC’s Telemarketing Sales Rule.

The notice and opt-out also do not apply if, among other things:

1. One company (Company B) uses the information to perform services on behalf of its affiliate (Company A), except that Company B may not solicit a consumer whom Company A could not have solicited because of an opt-out.
2. The consumer initiates a contact and the affiliate uses the information to respond.
3. The consumer authorizes or requests the solicitation.

Rulemaking. The federal banking agencies, the National Credit Union Administration (“NCUA”), the Securities and Exchange Commission, and the FTC

must issue regulations implementing the affiliate-sharing provision. Final regulations implementing this provision were to have been issued by September 4, 2004, with an effective date no later than six months later (*i.e.*, March 4, 2005). The agencies issued proposals with a comment deadline in mid-August 2004. Because the agencies did not issue final rules by September 4, 2004, these rules are still not in effect. A November 30, 2004, letter from the general counsels of the agencies with rulemaking authority under FACTA stated that they would not enforce FACTA provisions that are to be implemented by regulation until those regulations become effective.

Key provisions of the proposed regulations include:

1. Responsible Party for Issuing the Opt-Out. The “sharing” company (the company that provides the information) would be responsible for providing the opt-out notice, although FACTA does not assign responsibility for providing the notice. As drafted, the proposals do not address the common situation in the mortgage industry in which one entity (*e.g.*, a mortgage company) markets products (*e.g.*, HELOCs) on behalf of an affiliate (*e.g.*, a bank). MBA is seeking a broader definition of a “preexisting business relationship” in which, in this example, the mortgage company would be deemed to have a business relationship with the customer with respect to the HELOC as well as with loans actually originated by the mortgage company.

2. Statement Stuffers. As required by FACTA, the proposed regulation would allow a company to include a “statement-stuffer” promoting an affiliate’s products, in which the customers who receive the material are not selected using “eligibility information” that is covered by the rule. In other words, Bank A could include a statement-stuffer soliciting business for its affiliate, Mortgage Company B, so long as the material went to all of Bank A’s customers or a subset selected using non-financial criteria such as the customer’s place of residence.

- The agencies requested comment on whether a statement-stuffer promotion should be allowed where the material includes a code that reveals eligibility information to the affiliate when the customer responds to the offer, allowing what they refer to as “constructive sharing” of the information by the affiliate without the opportunity for the consumer to opt-out. MBA argued that the new FACTA provision should not apply to this situation because, once the consumer responds, the affiliate only uses the information in response to a customer inquiry, a situation that is excluded from the opt-out requirement by the statute and the proposed regulation. It argued that coding the material does not defeat the purposes of the provision, because the information is never “used” for marketing.

3. Electronic Disclosure. The proposed regulations are ambiguous on how the new affiliate-sharing notice could be given electronically. The proposed regulations would allow companies to comply with either Section 101 of the Electronic Signatures in Global and National Commerce Act (“ESIGN”) or with special rules for electronic disclosures set out in the regulations, which include requirements that the consumer consent to and acknowledge the receipt of electronic disclosures. But because the provision does not require written disclosures, MBA noted that the ESIGN Act does not require consumer consent for electronic delivery of these disclosures.

D. Medical Information

FACTA imposes new limits on a credit bureau’s ability to furnish, and a lender’s ability to use, information related to a consumer’s medical condition, in connection with extending credit:

1. Among other things, the law prohibits CRAs from reporting information about an individual’s payment history with a medical provider if the report will reveal the nature of the medical condition to which the bill related.
2. Information about a consumer’s payment record may be provided if it is coded so that the identity of the specific provider or the medical services, products, or devices cannot be determined.

These new restrictions could create difficulties for mortgage lenders seeking to avoid accusations of “predatory lending.” For example, they could prevent lenders who learn that an applicant receives mental disability income from evaluating the applicant’s legal capacity to enter into a contract. The rules do allow the use of medical information in connection with determining whether use of a power of attorney or legal representative triggered by a medical event or condition is necessary and appropriate, or whether the consumer has legal capacity to contract when another person seeks to represent the consumer.

Sharing of Medical Information. The law also restricts the sharing of medical information among affiliates, despite the general exception from FCRA for such sharing.

Rulemaking. FACTA, however, also requires the banking agencies and the NCUA to create exceptions that they determine are “necessary and appropriate to protect legitimate operational, transactional, risk, consumer, and other needs”:

1. The FRB, OCC, OTS, FDIC, and NCUA issued interim rules in 2005, which became final on April 1, 2006. Although the rules only apply to institutions under the jurisdiction of those agencies, they also include interpretations that allow all creditors to “rely on the

exceptions for obtaining and using medical information in connection with credit eligibility determinations.”

2. The rule allows credit bureaus to furnish, and lenders to use, reports that reveal medical information if:
 - “The information is the type of information routinely used in making credit eligibility determinations, such as information relating to debts, expenses, income, benefits, collateral, or the purpose of the loan, including the use of proceeds”;
 - “The creditor uses the information in a manner and to an extent . . . no less favorable than it would use comparable information that is not medical information in a credit transaction”; and
 - “The creditor does not take the consumer’s physical, mental, or behavioral health, condition or history, type of treatment, or prognosis into account as part of any such determination.”

The same exceptions apply to sharing of information with affiliates.

At the request of the FTC, which has jurisdiction over non-bank users of credit information, the final rule interprets the exceptions as applying to all “creditors,” including non-bank lenders:

- As a result, non-bank creditors may also use medical information in connection with credit eligibility determinations, so long as they do not treat it less favorably than comparable non-medical information.
- The FTC could also create exceptions to the restrictions, but in its view, only with regard to sharing of information among affiliated companies. The FTC has not issued a proposal for exemptions for affiliates.

E. Identity Theft Provisions

FACTA includes a number of provisions designed to help consumers who are, or believe themselves to be, victimized by identity theft. A CRA must note that a consumer alleges that he or she has been a victim of fraud (including identity theft) or is on active military duty. Users of credit reports must verify the identity of consumers who have “alerts” in their credit reports before making loans to them. **Failing to take these steps exposes the user of the report to liability for violating FCRA, in addition to the losses associated with an identity theft.**

Alerts in Consumer Credit Reports:

1. Two levels of alerts are provided for identity theft alerts – fraud alerts, which can be initiated with a telephone call and are valid for 90 days, and “extended” alerts, which can be valid for up to seven years. Active duty alerts are valid for one year.
2. In order to place any type of alert, the consumer must provide appropriate proof of identity. An extended alert also requires the filing of a police or similar report.
3. The level of identification required for a fraud or active duty alert is lower than for an extended alert:
 - **Verification of Identity for Fraud Alerts and Active Duty Alerts:** For a fraud or active duty alert, the lender or other user must “utilize reasonable policies and procedures to form a reasonable belief that the user knows the identity of the person making the request” for credit. If a credit report that has an alert provides a telephone number for lenders to use to verify the identity of the applicant, the user must either call that number or take other reasonable steps to verify identity and confirm that the request for credit is not the result of identity theft.
 - **Verification of Identity for Extended Alerts.** For extended alerts, the user must contact the consumer in person, by telephone, or through another reasonable contact method designated by the consumer. The “other reasonable steps” option is not available.
 - Users do not have to follow these special procedures for extensions of credit on an existing credit line, but they do have to follow them for requests to increase the credit limit.
 - **Free Credit Reports.** Consumers who file alerts have additional rights to free credit reports. This creates the potential for abuse by consumers being advised by unscrupulous “credit repair” firms.

ECOA Implications of Alerts

The FDIC issued a letter reminding lending institutions that ECOA prohibits discrimination in credit transactions against customers who have exercised rights under the Consumer Credit Protection Act, which includes the right to post an alert under FCRA.

- The FDIC noted that it had learned of creditors that denied applications for credit outright if there was a fraud or active duty alert on the consumer’s credit report.
- Instead, according to the FDIC, institutions should have procedures to verify the identity of an applicant whose credit report contains an alert.

The identity theft provisions of FACTA also:

1. **Blocking of Information.** Require credit bureaus to block reports of items that were generated by an identity thief, and notify the entity that furnished the blocked information. (The furnisher's responsibilities not to "refurnish" information are discussed below.)
2. **Records.** Require the user of consumer reports, upon request of a victim of identity theft, to provide without charge application and transaction records related to the identity theft.
3. **Reconciling Addresses.** Require credit bureaus to alert lenders (and other users) when a request for a consumer report includes an address that differs from the address in the consumer's file. The lender must then take reasonable steps to confirm the identity of the consumer and determine there is no identity theft. This provision is to be implemented through a banking agency/NCUA/FTC regulation, which was published on July 18, 2006 (along with the proposed Red Flag guidelines discussed below), with a comment deadline of September 18, 2006.
 - Under those proposals, a lender must develop and implement reasonable policies and procedures designed to enable it, when it receives a discrepancy notice from a CRA, to form a reasonable belief that it knows the identity of the consumer or decide that it cannot form such a belief.
 - Lender must then provide the CRA with an address that it has reasonably confirmed is accurate.
 - A separate FACTA provision, also implemented in the proposed regulations, imposes additional responsibilities on credit- and debit-card issuers to implement reasonable policies and procedures to assess the validity of address changes.
4. **Red Flag Guidelines.** Require lenders to monitor and identify or flag patterns, practices or activities that would indicate identity theft. Failing to establish reasonable policies and procedures to implement the guidelines will be a violation of FCRA (although noncompliance with the guidelines will not, in itself, be a violation). In July 2006, the federal banking agencies, FTC, and NCUA published proposed guidelines and regulations, with a comment deadline of September 18, 2006.
 - The proposed guidelines would require a financial institutions or creditor to have a written program that includes controls to address identity theft risks identified through a risk assessment, including policies and procedures to identify "Red Flags" – "a pattern,

practice, or specific activity that indicates the possible risk of identity theft” – and take steps to mitigate them.

- An appendix lists examples of possible Red Flags, such as a fraud or active duty alert on a credit report, an unusual increase in the number of inquiries, new credit relationships shown on the credit report, discrepancies in identifying documents or personal information, and anomalous use of the account.

Rulemaking:

FACTA requires the FTC to issue regulations defining certain terms related to identity theft:

- The FTC issued rules in early November 2004 that define an “identity theft” as well as an “identity theft report” (a police report or similar report that triggers increased requirements for credit bureaus and users).
- In an attempt to prevent the use of the identity theft provisions in “credit repair” scams, the rule also addresses the amount of information that a credit bureau or lender may require before accepting an identity theft report as genuine.
- Some industry commenters believe the rules could be interpreted to convert any report of a stolen wallet into an identity theft report, triggering the alert provisions.
- Alerts began appearing in credit reports as of December 1, 2004, the effective date of the FACTA provision.

FACTA also requires the FTC, in consultation with the federal banking agencies and NCUA, to develop a model form and procedures for consumers to use to report identity theft to lenders and CRAs:

- The FTC has done so by issuing a revision of its consumer brochure on identity theft entitled, *Take Charge: Fighting Back Against Identity Theft*.
- The publication includes an ID Theft Affidavit and sample letters, as well as explanations on when to use the forms to report identity theft.
- The booklet may be found at <http://www.ftc.gov/bcp/online/pubs/credit/idtheft.htm>.

F. Furnisher Responsibilities

FACTA increases the responsibilities of lenders and others who furnish information to CRAs. As under previous law, there is no requirement in FCRA to provide information to a CRA, but once a lender decides to do so, it has some responsibilities for the accuracy of the information:

- The standard for the furnisher's duty to furnish accurate information is changed from "knows or consciously avoids knowing that the information is inaccurate" to "knows or has reasonable cause to believe that the information is inaccurate."
- The "reasonable cause to believe" standard is defined as "having specific knowledge, other than solely allegations by the consumer, that would cause a reasonable person to have substantial doubts about the accuracy of the information."

Disputing Information on a Credit Report; Furnisher Guidelines. The banking agencies, NCUA, and FTC are directed to issue regulations establishing the circumstances under which a consumer can dispute the accuracy of information that a furnisher is reporting directly with the furnisher. The agencies must also create guidelines for furnishers regarding "the accuracy and integrity of the information" that they furnish to CRAs.

- **Direct Disputes.** The direct dispute procedure is similar to the "qualified written dispute" procedure under the Real Estate Settlement Procedures Act ("RESPA") and requires that:
 1. The consumer explain and document the dispute.
 2. The notice of dispute must be sent to an address specified by the furnisher.
 3. The furnisher will have to resolve the dispute and either correct its reporting or explain why it disagrees with the consumer within the same 30 -45 day time that a CRA would have if the consumer had disputed the item directly with the CRA
- **Accuracy Guidelines.** The banking agencies, NCUA, and FTC must also create guidelines for furnishers regarding "the accuracy and integrity of the information" they provide to CRAs, as well as rules requiring furnishers to establish reasonable policies and procedures to follow the guidelines:
 1. Failure to follow the guidelines will not, in itself, violate FCRA, but failure to establish reasonable policies and procedures will be a violation.

2. The guidelines, as described in the statute, use the term “integrity,” rather than “completeness,” which was used in earlier versions of the legislation.
- **Request for Comment. The federal banking agencies, NCUA, and FTC on March 22, 2006, issued an Advance Notice of Proposed Rulemaking (ANPR) in which they seek comments on the practices of furnishers. They will use the information received to develop proposed rules governing raising disputes directly with furnishers and the new accuracy and integrity guidelines.**
 1. The agencies are seeking factual information about furnishers’ practices, such as the types of problems that may impair the accuracy and integrity of information furnished to CRAs, the ways that furnishers provide that information, and current methods of investigating consumer disputes.
 - For example, the ANPR asks for “patterns, practices, and specific forms of activity that can compromise the accuracy and integrity of information furnished to consumer reporting agencies,” such as sale of debts to collection agencies and conversion of information into standard forms. It then asks for a detailed description of “the policies and procedures that a furnisher should implement and maintain to identify, prevent, or mitigate those” problems.
 - Similarly, the ANPR asks for a description of controls that furnishers have put in place to ensure the accuracy and integrity of the information they furnish to CRAs, and which of these should be mandated in the guidelines.
 2. The ANPR also seeks comments on the types of disputes a consumer should be allowed to raise directly with the furnisher, and the costs and benefits to consumers, furnishers, and CRAs of allowing direct dispute resolution.
 3. Comments on the ANPR are due by May 22, 2006.
 - MBA has been working with the FRB, which is conducting a FACTA-mandated study of furnisher issues, to avoid duplicative or contradictory requirements under RESPA and the FACTA provisions.

In August 2006, the FTC and FRB released a FACTA-mandated study on the steps that CRAs and furnishers take in response to consumer disputes. The study did not reach any definitive conclusions on whether current responses are adequate. The agencies did not make any legislative or administrative recommendations for improvements to the dispute process, believing that the enhancements in FACTA should be given time to work before further changes are made.

Under the identity-theft provisions, a mortgage banker furnishing information to CRAs:

1. Must establish reasonable procedures to avoid “refurnishing” information to a CRA if the CRA has informed the furnisher that the information has been “blocked” because of identity theft.
2. May not sell a loan or place it for collection if reporting of information about the loan has been “blocked.”
3. If it receives an “identity theft report” (such as a police report) directly from the consumer at an address established to receive such reports, must stop furnishing the information, unless the consumer informs the furnisher that the information is correct. This provision would also appear to create opportunities for abuse, especially given the broad definition of an identity theft report adopted by the FTC rule.

G. National Uniformity

Prior to the enactment of FACTA, FCRA preempted state law in a number of areas, but FCRA did not preempt any state law enacted after January 1, 2004, that (1) stated explicitly that it was intended to “supplement” the federal FCRA, and (2) provided more consumer protection than the federal law. FACTA eliminated the ability of states to “opt-out” of federal preemption beginning in 2004; in other words, the existing preemption provisions are now permanent.

The areas originally subject to federal preemption were:

- Exchange of information among affiliates;
- Adverse action;
- Pre-screened solicitations based on consumer reports;
- Prohibition against reporting obsolete information (generally 7 years for adverse trade and collection items and 10 years for bankruptcies);
- Responsibilities of furnishers of information to CRAs;
- CRA dispute-resolution procedures; and
- Form and content of the summary of rights that CRAs must provide to consumers who request file disclosures.

California and Preemption. In the first of these areas, exchange of information among affiliates, FCRA on its face preempts not only state laws concerning consumer reporting, but all state laws regulating sharing of any type of information among affiliates. Although a decision by the U.S. Court of Appeals

for the Ninth Circuit cast doubt on whether provisions of California’s privacy law, S.B. 1, regulating the exchange of information among affiliates, are preempted by FCRA, the most recent trial-level court decision indicates that FCRA completely preempts S.B. 1. The Ninth Circuit had held in the *American Bankers Association v. Lockyer* case that the FCRA provision might not preempt the California law in situations in which sharing among affiliates involves information that is not “consumer report information” within the meaning of FCRA. When that decision was remanded to the U.S. District Court for the Eastern District of California, however, the district court held that FCRA preempts all of the affiliate information-sharing provisions of California’s S.B. 1. The district court stated that it would be impossible to determine in advance whether information would be used for an “FCRA authorized purpose,” and, therefore, applying S.B. 1 would place financial institutions in an “untenable situation.” That district court decision is now on appeal, so that it is still uncertain whether S.B. 1’s affiliate-sharing rules will ultimately be viewed as completely preempted.

FACTA also preempts state laws governing the subject areas of new provisions that it added to FCRA, including:

- Risk-based pricing notices;
- Credit score disclosure (existing laws grandfathered);
- Use of affiliate information for marketing;
- Fraud alerts;
- Blocking of information allegedly generated by identity theft;
- Prohibition on “refurnishing” fraudulent information;
- Prohibition on the sale or transfer of fraudulent debt;
- The requirement for lenders to provide information to victims of identity theft;
- Red-flag alerts;
- Disposal of credit report information;
- Truncation of credit- and debit-card account numbers;
- Truncation of social security numbers in credit reports;
- Notice by debt collectors of fraudulent information;
- Annual free credit reports;
- New summaries of rights; and

- Government coordination of identity theft complaint investigations.

As discussed in more detail below, FACTA directs the FRB and FTC to issue regulations establishing effective dates for many of the law's provisions. The agencies issued a regulation setting December 31, 2003, as the effective date for preemption. This ensured that there would not be a gap during which states could enact legislation covering areas previously preempted by FCRA. At the same time, the preamble to the final rule states that new requirements added by FACTA do not preempt state law until the accompanying substantive rule goes into effect. For example, state law requirements for merchants to truncate credit card numbers on receipts will continue in effect until the corresponding FACTA provisions become effective.

H. Effective Dates

As required by FACTA, the FRB and FTC in February issued a joint rule setting final effective dates for the provisions of the law that do not specify an effective date:

- As noted, the effective date for existing preemption provisions was December 1, 2003.
- The final rule also established March 31, 2004, as the effective date for provisions that are “self-executing” (i.e., do not require rulemaking), and which the FRB and FTC believe do not require operational changes by industry. These provisions include:
 1. The extension of the statute of limitations to include a “discovery rule” that allows plaintiffs to bring an action within two years of discovering a violation or five years after the violation occurred, whichever is later. The rule does not address whether claims that were barred by the old version of the statute are now “revived” by the new, longer statute of limitations.
 2. The new definitions added by FACTA (other than those to be defined by regulation);
 3. A savings clause that states that nothing in FACTA affects liability existing on the day before enactment; and
 4. Clerical amendments.
- The final rule sets December 1, 2004, as the effective date for the remaining rules for which the statute itself does not specify an effective date. As noted above, however, the general counsels of the agencies with rulemaking authority under FACTA have stated that their agencies would not enforce FACTA provisions that are to be implemented by regulation until those regulations become effective.

- These provisions include, among others:
 1. The required credit score disclosure for mortgage bankers and brokers (as well as CRAs);
 2. The risk-based pricing (“RBP”) notice provision;
 3. The provisions relating to identity theft, including the fraud and active-duty alert provisions, blocking of reporting, and "red-flag" identity theft procedures;
 4. Notice of reporting negative information to CRAs;
 5. The new furnisher provisions;
 6. Enhanced prescreen notices;
 7. Summaries of consumer rights; and
 8. Coordination of government identity theft complaint investigations;

The FACTA statute itself bases the effective dates for other provisions on when final rules are issued. For example, the pending proposed affiliate-sharing rule would go into effect 6 months after issuance in final.

- New restrictions on medical information:
 1. Restrictions on sharing medical information were generally effective June 1, 2004; but
 2. Restrictions on *use* did not become binding until April 1, 2006, as specified in the banking agency/NCUA regulations.

I. Other Provisions

Other provisions of FACTA with some impact on the mortgage industry include:

- 1. An annual free credit report, which allows a consumer to request and obtain a free copy of their credit report once a year:**
 - a. This requirement was phased- on a geographic basis, with nationwide coverage achieved on September 1, 2005.
 - b. The increased volume of such consumer requests imay have had an indirect impact on lenders by generating an increased number of disputed items that lenders must verify.
- 2. Model notice that lender may report negative credit information:**

- a. Any “financial institution” (defined as in the Gramm-Leach-Bliley Act) must notify the consumer before reporting negative information about the consumer to a credit bureau.
- b. Use of the Gramm-Leach-Bliley definition of “financial institution” means that any mortgage lender is covered, regardless of whether it is affiliated with a bank.
- c. The notice may be provided with a notice of default, billing statement, or otherwise, but may not be provided with Truth in Lending Act disclosures.
- d. FACTA directs the FRB to provide model language for the notice. The rule provides alternative notices for two situations: where the lender has not yet reported negative information, and where the lender has reported such information.
- e. In response to industry comments noting that not all negative information that a lender reports is actually reflected in the consumer’s credit report, the notices state that the information “may be” reflected in the consumer’s credit report, and also allow the lender to state that information “may be” reported, allowing for the possibility that negative information would not even be reported.

3. Disposal of consumer report information and records.

- a. FACTA requires the FTC, the federal banking agencies, the Securities and Exchange Commission, and the National Credit Union Administration (“NCUA”) to issue “consistent and comparable” (but not joint) regulations requiring the proper disposal of information from consumer reports. The FTC’s final regulations were published on November 24, 2004, while the banking agencies published their final rules on December 21, 2004. Both sets of guidance are similar, requiring organizations subject to their respective jurisdictions to implement processes for the proper disposal of consumer information.
- b. Banks and thrifts were required implement their information disposal plans by July 1, 2005. If, however, a bank or thrift entered into a contract before this date with a service provider that had access to consumer information and that may dispose of that information, then its contract with the service provider must comply with the Guidelines by July 1, 2006. In contrast, the FTC’s rules were effective on June 1, 2005, with no exception for existing contracts.

- c. The regulations and guidelines are very general and in many instances overlap with the existing requirements of the FTC Safeguards Rule and comparable banking agency guidance.
 - i. Both the FTC and the banking agencies define “consumer information,” subject to the requirements, as:
 - a) “Any record about an individual.” The rules do not apply if the record does not identify an individual (e.g., average credit score in portfolio, blind data with identifying information stripped or coded).
 - b) “In paper, electronic, or other form.”
 - c) “That is a consumer report or is derived from a consumer report.”
 - d) “That is maintained or otherwise possessed by or on behalf of the bank for a business purpose.
 - e) Also includes “a compilation of such records.”
 - f) Includes names, addresses, public-record information if derived from a consumer report.
 - ii. The FTC’s final regulations require that financial institutions properly dispose of consumer information by taking reasonable measures to protect against unauthorized access to or use of the information in connection with its disposal. Examples of such reasonable measures include implementing and monitoring compliance with policies and procedures that:
 - a) Mandate burning, pulverizing or shredding papers containing consumer information;
 - b) Mandate destruction or erasure of electronic media containing consumer information; and
 - c) Provide for due diligence and monitoring of third parties engaged in the business of record destruction to dispose of such material.

Moreover, entities that are subject to the FTC Safeguards Rule should incorporate compliance with this rule into their FTC Safeguards Rule security program. The FTC has indicated that the scope of the new rule is similar, although not identical, to the scope of the Safeguards Rule; accordingly, those in compliance

with the Safeguards Rule may already be in substantial compliance with the new disposal rule.

- iii. Banking agency guidelines are more general:
 - a) The guidelines simply require banks and thrifts to comply with the banking agencies' general information-security guidelines issued under Gramm-Leach-Bliley as to consumer report information.
 - b) Those guidelines have many of the same requirements as the new FTC consumer-information rule.
 - c) The banking agency guidelines are not binding regulations, meaning that a violation is not automatically a violation of banking law that subjects a bank to sanctions. As a practical matter, however, examiners will probably enforce the guidelines as if they were regulations.

4. Enhanced disclosures of right to opt-out of prescreened credit solicitations.

- a. Under FCRA, lenders that use credit-bureau prescreening must include a disclosure in their solicitations that informs consumers of their right to opt-out of future prescreened solicitations. FACTA requires the FTC to issue simplified, clearer language for this opt-out notice. The FTC's final rule, which became effective on August 1, 2005, requires a very prominent opt-out notice on the first page of a solicitation and specifies more detailed language that may be included elsewhere.
- b. The regulations require provision of a two-part notice consisting of short and long formats. Both parts of the notice emphasize the consumer's right to opt-out of future prescreened solicitations.
 - i. The short form notice must accompany the "principal promotional message," such as a cover letter in a paper solicitation, or be on the same web page as the "principal marketing message" (*i.e.*, the first web page, although not necessarily on the same screen) if delivered in an electronic message. The disclosure must be placed in a border or be otherwise distinct from the surrounding text, and must be presented in a type size that is at least 12-point type, and larger than the type size of the solicitation's main text.
 - ii. The longer-form notice must be presented in the greater of 8-point type or the solicitation's type size. It must contain all of the

information required by FCRA Section 615(d), which mandates a clear and conspicuous statement that:

- a) Information in the consumer's consumer report was used;
 - b) The consumer received the offer because the consumer satisfied the criteria for creditworthiness set forth for the offer;
 - c) If applicable, the credit or insurance would not be extended if the consumer does not in fact meet the criteria for creditworthiness after responding to the offer;
 - d) The consumer has the right to prohibit information that is contained in his or her file with a CRA from being used in connection with any credit or insurance transaction that the consumer does not initiate;
 - e) The consumer may exercise his or her right to prohibit the use of their information by notifying the proper notification system; and
 - f) Includes the address and toll-free telephone number of the notification system.
 - g) In response to an MBA comment, the notice includes optional language to disclose collateral requirements as required by FCRA: "This offer is not guaranteed if you do not meet our criteria [including providing acceptable property as collateral]."
- c. The regulation also includes model forms for compliance with the regulations.
 - d. The FTC regulation does not address how to determine if a "firm offer" has economic value to the consumer or how the credit offer should be described in the initial solicitation, major issues in recent nationwide class-action litigation.

J. Other FACTA Provisions

1. **Truncation of Credit/Debit Card.** Prohibits businesses from printing more than the last five digits of a credit or debit card number on an electronically-generated point-of-sale receipt. This would appear to apply, for example, to a mortgage originator that accepts credit-card payments for appraisal and application fees. This provision went into effect on January 1, 2005, for equipment that was in service as of

December 4, 2004, and will become effective on December 4, 2006, for new equipment.

2. **Extends the FCRA statute of limitations.** Extends the FCRA statute of limitations, allowing lawsuits within five years of the violation, and adds a "discovery rule" that also allows actions within two years of discovery (the latter overruling the Supreme Court decision in *TRW v. Andrews*, 534 U.S. 19 (2001)).
3. **Studies.** Requires various federal agencies to conduct studies of topics such as the impact of credit scoring on the availability and affordability of financial products (including the impact on minorities and certain geographical areas); the use of biometrics to prevent identity theft; whether restrictions on the use of prescreened information should be tightened.
4. **Financial Literacy and Education Commission.** Creates a Financial Literacy and Education Commission to develop a strategy to increase consumer financial understanding, composed of the Secretary of the Treasury, Chairs of the FRB, FTC, and SEC, heads of the other federal banking agencies, Secretaries of several other executive departments, and other high federal officials appointed at the President's discretion.