

GUIDELINES FOR MAKING FIRM OFFERS OF CREDIT

by Thomas J. Cunningham¹

As of the date of this writing in September, 2006, the mortgage lending industry is under siege by the plaintiffs' class action bar for alleged violations of the Fair Credit Reporting Act, 15 U.S.C. §§ 1681, *et seq.*. Over 100 cases have been filed in a number of jurisdictions (the majority in federal courts in Illinois and California), each alleging that the defendants knowingly and intentionally violated the FCRA by obtaining prescreened lists of consumer names and addresses without making a firm offer of credit as required by the Act.

The law in this area is developing rapidly and new opinions are being issued nearly every week. Given the evolving nature of the law and the fact that whether a particular offer of credit will be considered a "firm offer of credit" is highly dependent upon the specific facts related to the offer, it is impossible to offer any concrete "rules" for lenders to follow that will result in a conclusion that their offers qualify as "firm offers of credit." However, certain general guidelines can be drawn from the cases that have been decided so far. Lenders who adhere to these guidelines are far less likely to be sued, and will have much stronger defenses in the event they are sued.

The guidelines set forth here are merely general guidelines and suggestions. They are intended to provide lenders with the strongest possible defense against a challenge to their prescreening practices. They do not constitute legal advice. The specific facts and circumstances of any particular offer, along with numerous other circumstances including the jurisdiction in which a lawsuit is filed and the judge to whom the case is assigned can and will affect whether the offer is ultimately deemed to constitute a firm offer of credit. Finally, not all of these guidelines should be considered as "requirements" for compliance. Some of them are explicit requirements of the Act, but many others are merely suggestions. Lenders who do not adhere to all of the suggestions listed here are not necessarily violating the FCRA. These guidelines are merely intended as things a lender can do to minimize its exposure and present the strongest possible defense to a lawsuit alleging that the lender failed to make a firm offer of credit.

1. Establish Pre-Set Credit Criteria and Document It. A fundamental **requirement** of prescreening under the FCRA is that the lender establish pre-set underwriting criteria, that, if consumers who are prescreened continue to meet when they apply for the credit offered, will result in a loan approval. Approval can also be subject to provision of satisfactory collateral. What collateral will be considered

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“satisfactory” should also be documented. Documentation of the terms used to prescreen consumers **must** be maintained.

2. Establish Pre-Set Credit Terms and Document Them. This can be a challenge for mortgage lenders as interest rates change frequently due to market forces beyond their control. So far, courts have not indicated that the fact that an interest rate may change between the date the consumer’s name is obtained from a CRA and the date the consumer accepts the offer prevents the offer from being considered a “firm offer of credit.” However, the terms of the product should be as fixed as they reasonably can be. For example, the product offered should be identified as a particular product, such as a 30 year fixed rate first mortgage. Although the consumer may qualify for many products the lender offers, an offer of credit will be less susceptible to plaintiffs’ arguments that no real offer was made if the product is described with particularity. If feasible, adjustments to a “base” interest rate for particular attributes of the consumer or collateral that cannot be obtained through prescreening (such as loan-to-value ratios) should be fixed and should not change during the time period the offer can be accepted. While the base rate might fluctuate, the increase to that rate for loan with an LTV of 90% should remain stable. This will help support an argument that the offer is as firm as it reasonably can be. Another suggestion would be to tie the base rate to a particular index, such as the prime rate as published in the Wall Street Journal. Again, this is not required to comply with the Act, but such terms help establish the “firmness” of an offer. Similarly, the points and fees should not change during the time period the offer can be accepted, if reasonably possible.

3. Establish Systems to Ensure that Recipients of Prescreened Offers Can be Identified, and That Their Applications Are Judged by the Pre-Set Criteria. Once a prescreened consumer responds to the offer and seeks to accept it, the lender must have a system that will identify the consumer as the recipient of a prescreened offer of credit and ensure that the consumer’s application is evaluated using the same pre-set criteria used to select the consumer for the offer in the first place. For example, the lender might create a special toll free telephone number that is only given to the recipients of a prescreened consumer, or it might direct the consumer to apply by using a special web site that requires a password provided in the prescreened offer. Another suggestion is to provide a code on the mailer associated with the prescreened offer and indicate that to accept the offer, the consumer must inform the loan officer of the code so that the officer will know that the consumer has been prescreened. The lender’s computer system can then match up the code, or the password, or the fact that the call came in on a particular toll free line with the pre-set underwriting criteria used to select the consumer for the offer, and the terms of the product or products that the lender is offering.

4. Implement a System of Compliance Review. Preferably by trained compliance personnel and legal counsel. Loan officers should be specifically trained to identify consumers who have received prescreened offers of credit and ensure that they describe the terms of the specific product offered as a result of the prescreening, and also that the application is evaluated using the pre-set criteria used to select the consumer for the offer. Periodic updates and audits to ensure compliance will also provide a solid defense to any lawsuit.

5. Review Mailers Carefully. Much of the prescreening litigation has focused on the mailers or flyers lenders have sent to prescreened consumers. Plaintiffs contend that the mailers themselves are the offers, and that if the mailers fail to contain sufficient terms describing the credit product being offered, they do not constitute “firm offers of credit.” These issues are unresolved as of this writing, although some decisions have imposed liability upon defendants for failing to include certain terms, such as the amount of credit being offered, the interest rate, the method by which interest will be calculated, and the period of time permitted for repayment in the mailer itself. Mortgage lenders argue that many of those terms (including the amount of credit being offered and the interest rate) cannot be included in the mailer. Whether these arguments will be accepted remains to be seen, and mortgage lenders who continue to engage in prescreening face potential exposure in this area. This risk can be mitigated to a degree by disclosing in the mailer as many of the terms as possible. For example, the amount of credit can be expressed as “at least \$X, so long as you satisfy our income requirements and have sufficient equity in your home.” A mortgage lender might even be able to state that the recipient of the offer must have sufficient equity in his or her home to justify an loan of at least \$X at a loan-to-value ratio of Y%. The more terms and conditions that are expressed in the mailer, the more likely it is that a court will find that the mailer is a “firm offer of credit.”

Mailers should also be reviewed carefully by compliance and legal counsel to ensure that they are as specific as possible and that the mandated opt out disclosures are clear and conspicuous. Early prescreening cases focused heavily on alleged violations of section 1681m, which mandates that the opt out disclosures be clear and conspicuous. These claims are no longer of much concern due to the FACTA amendments that have almost uniformly been held to have eliminated private rights of action for violations of section 1681m and the issuance of the FTC’s Final Rule on opt-out disclosures, which sets forth in significant detail the content and format of compliant opt-out notices. If the Final Rule is faithfully followed, the lender should have little concern about potential liability pursuant to section 1681m.

This piece is intended solely for educational purposes. It is not intended to constitute legal advice or to create an attorney-client relationship. Readers must obtain legal advice specific to their particular enterprise and circumstances in connection with each of the topics addressed. The law in this area is developing rapidly, and the latest developments must always be taken into account.