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FHA Allows Nationwide Lending

On October 20, 2005, through the issuance of Mortgagee Letter 05-40 (ML 05-40), the FHA announced two changes to the geographic areas where mortgagees (including loan correspondents) may originate new single-family loans. First, the FHA has expanded all lending areas where each registered office of a lender may originate FHA-insured loans. Previously, the lender's approved lending area extended only to certain HUD field office jurisdictions contiguous to the location of the lender's approved office. In Mortgagee Letter 05-40, however, HUD announced that the lending areas now will be expanded to all HUD field office jurisdictions within groups of states.

Under current FHA rules, when the FHA approves a mortgagee to originate insured single family mortgages, each of the mortgagee's registered offices is restricted to originating mortgages only on properties that are located within that office's "Lending Area" (also known as the "Areas Approved for Business"). These lending areas are tied to the jurisdictions of HUD field office locations. Under this approach, a lender could achieve a nationwide FHA lending "footprint" by establishing approximately twenty-five (25) branches in selected locations throughout the U.S.

As revised by Mortgagee Letter 05-40, however, the use of the new expanded lending areas potentially would allow the lender to establish a nationwide lending "footprint" with as few as

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Federal Courts Begin to Apply Class Action Fairness Act

The much-anticipated Class Action Fairness Act of 2005 ("CAFA") was signed into law on February 18, 2005 in order to, among other things, expand federal jurisdiction to include interstate class actions in which: (1) the aggregate amount in controversy exceeds $5 million; (2) any member of a class of plaintiffs is a citizen of a state different from any defendant; (3) the primary defendants are not states, state officials, or other government entities against whom the district court may be foreclosed from ordering relief; and (4) the number of members of the plaintiff class numbers 100 or more. (A more complete review of CAFA's provisions was reported in the March 2005 edition of the WBSK Mortgage Finance Newsletter.) CAFA was enacted amidst concerns that existing jurisdictional standards facilitated class action abuse in the state courts and thwarted the underlying purpose of the constitutional requirement of diversity of the parties' citizenship. CAFA was designed to address these problems by establishing a "balanced diversity" rule, thereby permitting a larger number of class actions to proceed in the federal courts.

Nine months later, the federal courts have only begun to interpret the Act's provisions. As with any federal legislation of such prominence, the courts have not always agreed how CAFA should be applied.

A SUIT "COMMENCES" IN STATE COURT

One point which the courts to date have agreed upon, however, is that CAFA cannot be applied retroactively to cases filed in state courts prior to February 18, 2005. The First Circuit Court of Appeals in *Natale v. Pfizer, Inc.*, __ F.3d __ (1st Cir. 2005), the Seventh Circuit Court of Appeals in *Knudsen v. Liberty Mutual Insurance Co.*, 411 F.3d 805 (7th Cir. 2005) and *Pfizer, Inc. v. Lott*, 417 F.3d 725 (7th Cir. 2005), and the Tenth Circuit Court of Appeals in *Pritchett v. Office Depot, Inc.*, 404 F.3d 1232 (10th Cir. 2005), have each concluded that the term "commenced" in CAFA's enacting clause refers to the date the action was first filed in state court, not the date that it was removed to federal court. Section 9 of the Act states that "[t]he amendments made by this Act shall apply to any civil action commenced on or after the date of enactment of this Act."

District courts in other federal circuits have reached the same conclusion in numerous other opinions. For example, in one memorable published opinion, *Lander and Berkowitz, P.C. v. Transfirst Health Services, Inc.*, 374 F. Supp. 2d 776 (E.D. Mo. 2005), Judge Sippel of the United States District Court for the Eastern District of Missouri held that the date of CAFA's enactment was the day it was actually signed into law by the President, not the day Congress passed the bill that ultimately became CAFA. Tongue in cheek, Judge Sippel noted that "[a]lthough it is certainly not binding precedent, the parties may recall a popular episode of the television series Schoolhouse Rock titled *I'm Just a Bill*. In that episode, Bill sang, 'I'm just a bill/Yes, I'm only a bill/And if they vote for me on Capitol Hill/Well, then I'm off to the White House/Where I'll wait in a line/With a lot of other bills/For the president to sign/And if he signs me, then I'll be a law/How I hope and pray that he will/But today I am still just a bill.'"

Although the federal courts to date have been unanimous in holding that an action "commences" the day it is filed in state court, some courts have found that CAFA can be applied to cases filed in state court

prior to CAFA's enactment date if a subsequent change in the scope of the litigation was sufficiently dramatic that courts would treat it as a new claim. In *Plummer v. Farmers Group, Inc.*, No. CIV-05-242, 2005 WL 2292174 (E.D. Okla. Sept. 15, 2005), the district court found that if a post-enactment amendment to the plaintiff's complaint constitutes a "*de facto* commencement of a new suit," then CAFA may apply. The *Plummer* suit was initially filed in Oklahoma state court on August 15, 2003, by single plaintiff with a single cause of action. On May 23, 2005, however, the plaintiff filed an amended pleading adding two additional causes of action and purporting to represent a national class. The defendant removed pursuant to CAFA. Stating that the central question was whether the defendant had such notice of the added claims at the time the suit was initially filed that relation back of the added claims would unduly prejudice the defendant, the United States District Court for the Eastern District of Oklahoma held that, under the circumstances, the amended pleading constituted "a *de facto* commencement of a new suit." The court nonetheless remanded the case on other grounds.

The Seventh Circuit reached a different result in *Schillinger v. Union Pacific Railroad Co.*, __ F.3d __ (7th Cir. 2005), in which the defendant railroad companies removed to the Southern District of Illinois under CAFA. The defendants acknowledged that the filing of the suit predated CAFA, but argued that the reinstatement of an additional defendant and the expansion of the class definition changed the case so dramatically that it created a new claim. The federal district court remanded to state court. The Seventh Circuit denied defendants' petition for appeal, holding that the apparent reinstatement of a defendant who had previously been voluntarily dismissed was merely a "scrivener's error" and that the expansion of the class was not significant enough to create a new claim or new action. The Seventh Circuit had also previously held in *Schorsch v. Hewlett-Packard Co.*, 417 F.3d 748 (7th Cir. 2005) that that a change to the proposed class definition occurring after CAFA's effective date did not constitute the commencement of new claim.

THE PRESUMPTION IN FAVOR OF FEDERAL JURISDICTION

With the passage of time, however, the federal opinions have become less concerned with whether CAFA applies to cases filed prior to CAFA's enactment date, and more concerned with how the Act should be substantively interpreted and applied. The issues that seem destined for a judicial showdown are whether a removing defendant bears the burden of establishing federal jurisdiction and whether a court's doubts about the propriety of a removal should be resolved in favor of or against remanding the case to state court.

In the pre-CAFA era, it was undisputed that federal courts were required to strictly construe the removal statutes, including 28 U.S.C. § 1446, against permitting federal jurisdiction. As part of this presumption against against removal, the courts placed the burden of proving that re-moval was proper squarely on the removing party. The legislative history of CAFA, however, suggests an intent to reverse this presumption in the class action context and shift the burden of proof to the remanding party. For example, in one floor statement, Congressman Sensenbrenner opined that CAFA "should be read broadly, with a strong preference that interstate class actions should be heard in a Federal court if removed by any defendant." Likewise, the Senate Report prepared in connection with the bill that became CAFA states that "it is the intent of the Committee that the named plaintiff(s) should bear the burden of demonstrating that a case should be remanded to state court (e.g., the burden of demonstrating that more than two-thirds of the proposed class members are citizens of the forum state). Allocating the burden in this manner is important to ensure that the named plaintiffs will not be able to evade federal jurisdiction with vague class definitions or other efforts to obscure the citizenship of members."

Seizing on these congressional clues, the United States District Court for the Central District of California found in *Berry v. American Express Publishing Corp.*, 381 F. Supp. 2d 1118 (C.D. Cal. 2005), that Congress "clearly" expressed its intention to place the burden of proof on the party seeking remand. The *Berry* plaintiff had filed his class action in the Orange County Superior Court on March 3, 2005, alleging that the defendants' practice of charging credit credit holders for unsolicited magazine subscriptions was deceptive and violated several provisions of the California Civil Code. Although the plaintiff had been able to reverse the charges and cancel an unwanted subscription, he nonetheless sought to enjoin the defendants from continuing their practice. Notably, the plaintiff did not seek monetary damages and, to avoid federal jurisdiction under CAFA, explicitly pled that no amount was sought that would exceed the sum or value of $5 million.

On April 1, 2005, the *Berry* defendants removed the case to federal court on the basis of CAFA. They contended that the cost of complying with the plaintiff's requested injunctive relief would exceed $5 million and that, accordingly, removal was proper. The plaintiff moved to remand the case to state court on the grounds that defendants retain the burden of proving the propriety of removal and that this burden could not be met where the only relief sought was injunctive, rather than monetary, in nature.

Although ultimately remanding the case to state court on the ground that the $5 million cost of complying with the injunction was "wholly speculative," the *Berry* court did hold that the burden of proving jurisdiction rests exclusively on the party seeking remand and that the $5 million jurisdictional amount could potentially be satisfied by the aggregate cost to a defendant of complying with a requested injunction. The court held that committee reports are an authoritative source for ascertaining congressional intent and that the Senate Report on CAFA "expresses a clear intention" to place the burden of proof "on the party opposing removal to demonstrate that an interstate class action should be remanded to state court." The court observed that "[a]lthough plaintiff argues that the failure to incorporate this directive on the burden of proof into the statute evinces an explicit intent to maintain the status quo," the failure to address the burden of proof in the Act "reflects the Legislature's expectation that the clear statements in the Senate Report would be sufficient to shift the burden of proof." The court further held that, in the pre-CAFA era, "the Ninth Circuit did not permit the value of injunctive relief sought in a class action to be determined by examination of its potential aggregate cost to the defendant," but that "[g]iven the explicit statutory change allowing aggregation of claims in class actions, it appears as though the justifications previously advanced for considering only the value to individual plaintiffs in a class action are no longer relevant."

Courts that, like *Berry*, have found that CAFA shifts the burden of proof to the party seeking remand include *Lussier v. Dollar Tree Stores, Inc.*, No. CV 05-768, 2005 WL 2211094 (D. Or. Sept. 8, 2005), *Harvey v. Blockbuster, Inc.*, 384 F. Supp. 2d 749 (D.N.J. 2005), *Natale v. Pfizer, Inc.*, No. Civ.A.05-10590, 2005 WL 1793451 (D. Mass. July 28, 2005), *Waitt v. Merck Co.*, No. C05-0759, 2005 WL 1799740 (W.D. Wash. July 27, 2005), *In re Textainer Partnership Securities Litigation*, No. C05-0969, 2005 WL 1791559 (N.D. Cal. July 27, 2005), and *Yeroushalmi v. Blockbuster, Inc.*, No. CV 05-225, 2005 WL 2083008 (C.D. Cal. July 11, 2005).

JUDICIAL DIVISIONS EMERGE

Other federal district courts, however, have expressly rejected *Berry*'s use of CAFA's legislative history in shifting the burden of proof.

In *Schwartz v. Comcast Corp.*, No. Civ.A. 05-2340, 2005 WL 1799414 (E.D. Pa. July 28, 2005), the United States District Court for the Eastern District of Pennsylvania held that "notwithstanding its legislative history, CAFA does not shift the burden of proof from

a removing defendant to a remanding plaintiff." The *Schwartz* court reasoned that "Congress is presumed to have been familiar with the longstanding and well known case law construing old Section 1332," and, accordingly, the court "was hesitant to read into the statute a Congressional intent to shift the longstanding burden of proof for establishing diversity jurisdiction, where Congress expressly enacted numerous other intended changes discussed by the Judiciary Committee in its Report to the exclusion of the change with respect to the burden of proof."

To date, the *Plummer* opinion, discussed above, appears to be the only other federal opinion directly in accord with *Schwartz*. Citing *Schwartz*, the *Plummer* court acknowledged that other cases have shifted the burden of proof to the remanding party, but stated that "[w]hile the purpose of CAFA may arguably militate in favor of reversing this burden, Congress did not expressly say so in the statute." Other federal district courts have simply assumed that the burden remains incumbent upon the removing party, without referring at all to CAFA's legislative history or purposes. Such cases include *Komeshak v. Concentra, Inc.*, No. 05-CV-261, 2005 WL 2488431 (S.D. Ill. Oct. 7, 2005), *Brill v. Countrywide Home Loans, Inc.*, No 05 C 2713, 2005 WL 2230193 (N.D. Ill. Sept. 8, 2005), and *Sneddon v. Hotwire, Inc.*, Nos. 05-0951, 2005 WL 1593593 (N.D. Cal. June 29, 2005).

The split among the federal district courts will ultimately require resolution in the courts of appeal. For now, the question of which party bears the burden of demonstrating that a case should be remanded to state court will remain an uncertainty. ■

Katrina and Rita Appraisal Exceptions

The federal financial institution regulators recently announced a temporary exception to the real property appraisal requirements in communities declared major disaster areas as a result of Hurricanes Katrina and Rita.

The federal Depository Institutions Disaster Relief Act of 1992 ("DIDRA") authorizes the Comptroller of the Currency, Federal Reserve Board, Federal Deposit Insurance Corporation, Office of Thrift Supervision and National Credit Union Administration (the "Agencies") to make exceptions to statutory and regulatory appraisal requirements for transactions located in areas in which the President determines that a major disaster exists. Any exceptions granted by the Agencies must expire not later than three years after the determination that a major disaster exists. The Agencies decided to grant the exceptions for the full three years, and the exceptions expire on August 29, 2008 with regard to Hurricane Katrina and on September 24, 2008 with regard to Hurricane Rita.

Based on the authority under the DIDRA, the Agencies granted relief from compliance with the appraisal requirements under Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), subject to four conditions. The conditions are that:

1. The transaction involves real property located in an area that (a) the President determined to be a major disaster area pursuant to Section 401 of the Stafford Disaster Relief Emergency Assistance Act as a result of Hurricane Katrina in Alabama, Louisiana and Mississippi or as a result of Hurricane Rita in Louisiana and Texas, and (b) has been designated by the Federal Emergency Management Agency ("FEMA") as eligible for certain federal assistance (Individual and Public Assistance for all categories or for categories A and B).
2. The real property involved (a) was directly affected by the major disaster, or (b) was not directly affected by the major disaster, but the transaction would facilitate recovery from the disaster.
3. There is a binding commitment to fund a transaction that is made within three years after the major disaster was declared by the President.
4. The institution must retain in its files, for examiner review, appropriate documentation indicating that the requirements of the first three conditions are met, and supporting the valuation of the real property.

The *Federal Register* release announcing the exceptions identifies the following counties and parishes as those designated by FEMA for the applicable federal assistance:

HURRICANE KATRINA

Alabama: Baldwin, Choctaw, Clarke, Greene, Hale, Mobile, Pickens, Sumter, Tuscaloosa and Washington.

Louisiana: Acadia, Ascension, Assumption, Calcasieu, Cameron, East Baton Rouge, East Feliciana, Iberia, Iberville, Jefferson, Jefferson Davis, Lafayette, Lafourche, Livingston, Orleans, Pointe Coupee, Plaquemines, St. Bernard, St. Charles, St. Helena, St. James, St. John the Baptist, St. Mary, St. Martin, St. Tammany, Tangipahoa, Terrebonne, Vermilion, Washington, West Baton Rouge and West Feliciana.

Mississippi: Adams, Amite, Attala, Choctaw, Claiborne, Clarke, Copiah, Covington, Forrest, Franklin, George, Greene, Hancock, Harrison, Hinds, Jackson, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lamar, Lauderdale, Lawrence, Leake, Lincoln, Lowndes, Madison, Marion, Neshoba, Newton, Noxubee, Oktibbeha, Pearl River, Perry, Pike, Rankin, Scott, Simpson, Smith, Stone, Walthall, Warren, Wayne, Wilkinson, Winston and Yazoo.

HURRICANE RITA

Louisiana: Acadia, Allen, Beauregard, Calcasieu, Cameron, Iberia, Jefferson Davis, Lafayette, Lafourche, St. Mary, Terrebonne and Vermilion.

Texas: Chambers, Galveston, Hardin, Jasper, Jefferson, Liberty, Newton, Orange and Tyler. ■

Federal Reserve Board Issues Second Round of Comment Requests for Changes to Regulation Z

The Federal Reserve Board ("Board") has published a second advance notice of proposed rulemaking ("ANPR") amending Regulation Z, the Truth in Lending Act ("TILA") regulation, with respect to the Regulation's open-end credit rules. This ANPR serves a dual function. In December of 2004, as part of its periodic review of its regulations, the Board published an ANPR requesting specific comments on Regulation Z's open-end credit rules. Then, on April 20, 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act ("Bankruptcy Reform Act"), which contained several amendments to TILA and its open-end credit regulations, was signed into law (see *WBSK Mortgage Finance Newsletter* June 2005 for more details). The Bankruptcy Reform Act requires the Board to adopt certain rules with respect to open-end credit plans. The second ANPR is the Board's attempt to address both the periodic review of Regulation Z and the Bankruptcy Reform Act regulations in one promulgation.

The initial comment period on the periodic review of Regulation Z closed on March 28, 2005. Now that the Board is implementing the Bankruptcy Reform Act rules in tandem with and as part of the periodic review amendments, it has reopened the comment period. Public comments are now due on or before December 16, 2005.

The integrated approach will permit the Board to conduct consumer testing as part of its development of the disclosures and guidance on the "clear and

conspicuous" standard that the Bankruptcy Reform Act requires. Until the new regulations become effective, the Board has advised that the "clear and conspicuous" standard currently provided for in Regulation Z will be the standard that will apply to all TILA disclosures, including the Bankruptcy Reform Act amendments.

MINIMUM PAYMENT DISCLOSURES

The Bankruptcy Reform Act requires creditors that extend open-end credit to provide a disclosure on the front of each periodic statement about the effects of making only minimum payments. The disclosure must include: (1) a "warning" statement indicating that making only the minimum payment will increase the interest the consumer pays and the time it takes to repay the consumer's balance; (2) a hypothetical example of how long it would take to pay off a specified balance if only minimum payments are made; and (3) a toll-free number that the consumer may call to obtain an estimate of the time it would take to repay their actual account balance.

The Bankruptcy Reform Act provides that the minimum payment disclosure requirement does not apply to a "charge card" account, the primary purposes of which is to require payment of charges in full each month. In the ANPR, the Board seeks comments on whether certain open-end accounts should be exempt from the minimum payment disclosure requirements.

The Board points out that the rationale behind the minimum payment disclosure requirements may not translate to certain types of transactions, such as home equity lines of credit ("HELOCs"), for which the length of time allotted to pay the outstanding balance is fixed and expressed in the credit agreement. Similarly, reverse mortgages may not be conducive to the minimum payment disclosure requirements since, typically, the principal and interest on a reverse mortgage are not due until some triggering event (i.e., the homeowner moves, sells the home or dies). In such cases where the payment dates are unknown, it would difficult to provide an estimate of the time necessary to pay off the account, as required under the minimum payment disclosures. With these considerations in mind, the Board asks whether certain transactions should be wholly or partially exempt from the minimum payment disclosure requirements.

With respect to the hypothetical example that must be provided with the disclosure, the Board asks whether it should revise the account balance, APR or typical minimum payment percentage used in the hypothetical example for open-end accounts other than credit card accounts, such as HELOCs. It also seeks guidance on what account balance, APR and typical minimum payment percentage should be used in the event that revision is in order.

With respect to the toll-free number that consumers could call to determine their payoff period, the Board has indicated that certain information will be required to be provided by the consumer in order for the payoff date to be determined. The Board has proposed three approaches to developing a system for calculating the repayment period for consumers who call the toll-free number:

- Prompting consumers to provide an account balance, a minimum payment amount and APRs in order to obtain an estimated repayment amount. For information about minimum payments and APRs that is not currently disclosed on periodic statements, the Board could require such information to be disclosed or develop a formula that makes assumptions about these variables for a typical account.
- Prompting consumers to input information, or using assumptions based on a typical account to calculate an estimated repayment period, but also giving creditors the option of inputting information from their own systems regarding the consumers' account termsto provide more accurate estimates.
- Prompting consumers to proide their account balance but requiring creditors to input information from their own systems regarding the account's minimum payment requirement and the portion of the balance subject to each APR.

"The Board points out that the rationale behind the minimum payment disclosure requirements may not translate to certain types of transactions, such as home equity lines of credit ("HELOCs") ..."

In addition to these three approaches, the Board has asked whether there are alternative approaches it should consider in developing the repayment calculation formula.

The Board seeks comments on whether it should select "typical" minimum payment formulas for various types of accounts, and if so, what the typical minimum payment formulas are for accounts other than general-purpose credit cards, such as HELOCs. The Board also asks whether its typical minimum payment calculation should assume that negative amortization is permitted.

In cases where multiple APRs apply to the subject credit transaction, the Board has asked whether it would be appropriate for the estimated repayment period to be calculated using a single APR (as contemplated in the Bankruptcy Reform Act), and if so, which APR should be used. The Board also asks whether it should develop a formula that uses multiple APRs but incorporates assumptions as to how those APRs should be weighted.

Because certain assumptions must be made in calculating the repayment period estimate, the Board seeks comments on whether certain key assumptions should be disclosed to the consumer. If so, clarification on which assumptions should be disclosed as well as the manner and timing of disclosure should be provided.

The Bankruptcy Reform Act permits creditors to omit the toll-free number on the minimum payment disclosure if, instead, the creditor provides the "actual number of months" to repay the account. The Board seeks clarification on how to determine whether a creditor has accurately provided the actual number of months to repay the outstanding balance, including whether there should be any safe harbors or tolerances in the calculation.

CLEAR AND CONSPICUOUS REQUIREMENT

The Bankruptcy Reform Act requires the minimum payment disclosures to be made in a clear and conspicuous manner. It further requires the Board to issue model disclosures and promulgate rules providing guidance on the clear and conspicuous requirement. The Board has asked for comments on what guidance it should provide on the location or format of the disclosures and whether a minimum type size requirement is appropriate. It also seeks comments on what model forms or clauses it should consider.

PAYMENT DEADLINE/LATE PAYMENT PENALTY DISCLOSURES

The Bankruptcy Reform Act's amendments to TILA require that creditors offering open-end plans provide additional disclosures on periodic statements if a late fee will be imposed for failure to make a payment on or before the required due date. This disclosure must state, in a clear and conspicuous manner, the date on which the payment is due or, if different, the earliest date on which a late payment fee may be charged. The disclosure must include the amount of the late payment fee that may be imposed.

The Board is seeking comments on the payment deadline/late payment penalty disclosure. Some comments it requests include

whether there are special considerations for open-end accounts other than credit cards (such as HELOCs) that it should consider, whether additional guidance on how to make the disclosure clear and conspicuous is needed and whether the Board should issue a rule requiring creditors to credit payments as of the date they are received (regardless of the time of day they are received). The Board also asks whether, in cases where a late payment triggers an increased APR, the late fee disclosure should include information about the increased rate.

DISCLOSURES FOR HOME-SECURED LOANS THAT MAY EXCEED THE DWELLING'S FAIR MARKET VALUE

The Bankruptcy Reform Act amended TILA to require that creditors extending home-secured credit (open-end and closed-end) include with each written advertisement relating to a credit product that may exceed the fair market value of the dwelling a clear and conspicuous statement that: (1) the interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for federal income tax purposes; and, (2) the consumer should consult a tax adviser for further information about the deductibility of interest and charges. The disclosure applies to advertisements circulated in paper form or on the Internet. Creditors must also make the above referenced disclosure at the time of application if the extension of credit exceeds or may exceed the fair market value of the dwelling.

The Board is seeking guidance on the factors to consider in interpreting when an "extension of credit may exceed the fair market value of the dwelling" and in determining whether the debt "may exceed" the fair market value. It also asks whether additional guidance is necessary with respect to the timing of the disclosures.

PROHIBITION ON TERMINATING ACCOUNTS FOR FAILURE TO INCUR FINANCE CHARGES

Under the amended TILA, creditors may not terminate an open-end credit plan before its expiration date solely because the consumer has not incurred finance charges on the account. An account that has been inactive for three or more consecutive months, however, may be terminated by the creditor.

The Board has asked what issues it should consider in determining when an account expires. It also asks whether there are special issues it should consider with respect to open-end credit plans other than credit card accounts. Finally, it asks whether it should provide guidance on what constitutes inactivity for purposes of this provision. ■

NATIONWIDE LENDING *CONTINUED FROM PAGE 1*

thirteen (13) offices (or only ten branch offices if the lender were to lend only in the contiguous 48 states, and not in Hawaii or Alaska). Mortgagee offices approved after the date of ML 05-40 will receive automatic access to the new expanded "lending areas." Mortgagee offices approved prior to ML 05-40 will automatically receive access to the expanded "lending areas" within 30 days of the date of ML 05-40.

Second, the FHA has announced that it will now permit approved mortgagees (including loan correspondents) to originate FHA-insured loans nationwide through the use of the Internet and/or a call center. This type of "direct nationwide" origination must meet all current FHA origination requirements and RESPA.

In order to lend nationwide through the Internet or call center, an FHA approved Title II mortgagee or loan correspondent must obtain such approval by requesting a separate ten (10) digit FHA branch ID number to be used for the sole purpose of direct (Internet or call center) nationwide lending. HUD will limit mortgagees to only one such branch ID number for its direct nationwide lending operation. HUD has also stated that the nationwide lending branch must have a separate manager (separate from that of any other branch of the lender), but the branch and its manager may operate out of an existing office of the mortgagee, or may establish a new physical location.

HUD has also announced the following policies and procedures for such nationwide Internet or call center lending authority:

- **The mortgagee or loan correspondent must submit a fully executed Branch Office Notification form (HUD 92001-B) to the FHA for review and approval. If HUD approves the branch for this purpose, then a separate 10-digit ID number will be assigned to the lender for direct (Internet or call center) lending only.**
- **The mortgagee also must submit a written request for the direct lending nationwide approval on its letterhead, signed by a Vice President or higher corporate officer, and include a statement in which the mortgagee it agrees that it will originate only direct mortgages through the branch ID number and not use the ID number to order case numbers for loans that are not originated through any means other than the internet and/or call center operation. By keeping the direct lending operation separate, and exclusively using this new ID number for the direct (Internet and call center) lending, HUD will be able to track and evaluate this type of loan origination, and it will not jeopardize the lender's other branch offices.**
- **In addition to the foregoing, the lender's letter also must include a list of the states where the mortgagee will engage in the origination of FHA single-family mortgages by direct nationwide lending. The letter must contain the following certifications as of the date of the request:**
  - **(i) the mortgagee has updated its quality control plan to include specific elements covering direct market lending;**
  - **(ii) the mortgagee has already obtained the appropriate state licenses and meets all other state requirements to originate loans in the specific states included in the request;**
  - **(iii) the mortgagee agrees to notify HUD in writing if it no longer meets the requirements of any of these states (which will result in the state being removed from the lending area of the direct lending branch);**
  - **(iv) neither the mortgagee nor any of its officers, directors, or principals or employees have been denied a license or otherwise sanctioned by any federal, state, or local agency or have been suspended, debarred, or otherwise denied participation in HUD programs.**

Similar to other branch office application requests, each request for a separate branch ID number for nationwide direct lending must include a $300 check payable to HUD as a nonrefundable processing fee. HUD will review all information and certifications provided and will also determine whether the mortgagee is in good standing with the HUD, including that it: (i) has no actions pending or unresolved issues with the Mortgagee Review Board; and (ii) has no unresolved audit findings with HUD's Quality Assurance Division or HUD's Office of the Inspector General. Following its review, the FHA will notify the mortgagee when the request is approved or disapproved.

Safeguarding Customer Data: What Are Your Obligations In Event of A Breach?

Since July 1, 2003, when California's Security Information Breach Act went into effect, twenty states (Arkansas, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Louisiana, Maine, Minnesota, Montana, Nevada, New Jersey, New York, North Carolina, North Dakota, Rhode Island, Tennessee, Texas and Washington) have joined California by enacting legislation imposing a duty upon organizations that own, license or maintain computerized data that contains personal information to alert consumers when their personal information has been compromised, or where the organization has reason to believe that such information has been compromised. Similar legislation is pending in seven additional states (Massachusetts, Michigan, Missouri, Ohio, Oregon, Pennsylvania and Wisconsin). These laws ("Data Security Laws") are intended, at least in part, to provide consumers with the information they need to help prevent identity theft.

Data Security Laws generally require any organization that stores personal information electronically to notify its customers of a data security breach in the most expedient time and manner possible after the determination of the breach. Certain states impose a specific timeline for such notice. For example, Florida law requires notification no later than 45 days following the determination of the breach, unless a delay is justified (as discussed below). Notice to consumers typically can be given in any of the following methods: in writing, by telephone, or electronically. In certain instances, such as when the cost of providing ordinary notice exceeds a certain level (typically $250,000) or the number of people affected is large (typically 500,000), "substitute notice" is permitted. Substitute notice generally consists of the following elements: (i) e-mail notice, if customer's e-mail address is known; (ii) conspicuous posting of the notice on the organization's web page, if a web page is maintained by the organization; and (iii) notification to major statewide media.

The term "data security breach" is generally defined as an unauthorized acquisition of computerized data that compromises the security, confidentiality, or integrity of customer's personal information. The term "personal information" is generally defined as a customer's first name or first initial and his or her last name, in combination with one or more of the following data elements: Social Security Number, driver license or state ID number, account, credit card or debit card number with the corresponding PIN code or password that would allow access to the customer's account. Certain states, however, define the term more broadly. In North Dakota, for example, the definition of personal information also includes such data elements as the customer's date of birth, the maiden name of the customer's mother, the customer's employer ID number, and the customer's digitized or other electronic signature. In Georgia, the duty to notify customers arises if the compromised information is sufficient to perform or attempt to perform an identity theft against the customer.

The duty to notify does not arise in connection with personal information that is lawfully made available to the general public. Also, most states create an exception if the compromised personal information was encrypted or redacted and thus rendered unreadable or unusable. Pennsylvania's pending legislation, however, states that even if the compromised personal information was encrypted, the duty to notify arises where there has also been a breach of the encryption system itself or where the breach involves a person with access to the encryption key.

Most states provide that compliance with internal notification procedures maintained as part of the organization's information security policy will be sufficient to comply with the notification requirements of the Data Security Laws. Internal procedures, however, must be reasonable and must be consistent with the state Data Security Laws in terms of their timing requirements.

The Data Security Laws typically contain exceptions to the notice and/or timing requirements. Notification often is not required if, after a reasonable investigation, the organization makes a determination that there is no reasonable likelihood of harm to the affected customers. Notification typically may be delayed in order to determine the scope of the breach and to restore the reasonable integrity of the computer data system in order to guard against further breaches. Notification may also be delayed if it becomes necessary to assist a law enforcement agency with a criminal investigation.

The cost of providing the required notification may be substantial. However, organizations that maintain computerized personal information must be aware that many states provide for penalties for failure to make timely notification. For example, Florida provides for fines of $1,000 per day for each day the breach goes undisclosed for up to 30 days and $50,000 thereafter for each 30-day period up to 180 days. In Texas, the fine for a violation of the data security breach notification law is at least $2,000 but not more than $50,000 for each violation. Many states also authorize private civil actions allowing affected individuals to seek damages. ■

States: Licensing Update

MICHIGAN: **Use of Temporary Employees**

Effective September 22, 2005, the Michigan Mortgage Brokers, Lenders, and Servicers Licensing Act (the "Act") was amended to permit the use of employees of professional employer organizations as residential mortgage originators by licensees and registrants. Specifically, employees of professional employer organizations (also known as temporary staffing agencies) that act as a residential mortgage originator on behalf of one licensee or registrant are not required to be licensed or registered under the Act. However, in connection with the employment of these individuals, a licensee or registrant must: (1) direct and control the activities of the individual employed by the professional employer organization; and (2) be responsible for all activities of the individual.

CALIFORNIA : **Amends Its Covered Loan Law**

California A.B. 901 amends the definition of "covered loan" contained in the California high cost home loan law by raising the dollar limit for mortgage loans to which such law potentially applies. California law currently defines a covered loan as a consumer loan secured by a deed of trust where the original principal balance of the loan does not exceed $250,000, and when one (or both) of the following "triggers" are met: (1) the APR at the consummation of the loan transaction exceeds by more than eight percentage points the yield on comparable Treasury securities; or, (2) the total points and fees payable by the consumer at or before closing of the loan will exceed six percent of the total loan amount.

California A.B. 901 raises the loan amount to mirror the conforming limits established by Fannie Mae. California A.B. 901 defines a covered loan as a consumer loan where the original principal balance of the loan does not exceed the most current conforming limit for a single-family first mortgage loan established by Fannie Mae (currently $359,650), and when one or both of the above triggers met. As amended, the California law potentially will impact more loans. The amendment goes into effect on January 1, 2006.

ILLINOIS: **National Bank Act Preempts State Law application to Operating Subsidiary Holder of Mortgage Loan**

In a matter that appears to be a case of first impression, the Appellate Court of Illinois in *Dannewitz, v. EquiCredit Corp. of America* upheld the dismissal of the plaintiff's claims against an assignee/holder of their mortgage, EquiCredit, a wholly owned subsidiary of a national bank, on the basis that the National Bank Act preempts the plaintiff's claims under several Illinois laws.

The originator of the loan, HomeGold, is a non-bank mortgage lending company incorporated in South Carolina. HomeGold assigned the loan to EquiCredit. EquiCredit is a wholly owned subsidiary of a national bank. The plaintiff's loan contained a prepayment penalty providing if the borrowers pre-paid the loan in full within 60 months of the date of the loan, the borrowers agreed to pay a prepayment fee. The Illinois Interest Act generally does not allow the imposition of a prepayment penalty in connection with a loan secured by a mortgage on residential real estate when the rate of interest exceeds 8% per annum. The mortgage also contained a clause stating that the loan is "governed by federal law and the law of the jurisdiction in which the property is located."

The plaintiff in *Dannewitz* alleged that the prepayment penalty contained in the mortgage loan contract originated by a state chartered lender violated the Illinois Interest Act as an unlawful charge, as well as the Illinois Consumer Fraud and Deceptive Business Practices Act due to the nondisclosure of the prepayment penalty. The Appellate Court of Illinois held, however, that because the claim was against the assignee and holder of the mortgage, EquiCredit, a wholly owned subsidiary of a national bank, the National Bank Act preempts the plaintiff's claims under these two Illinois laws.

In affirming the lower court's judgment, the Appellate Court of Illinois cited to *Beneficial National Bank v. Anderson*, 539 U.S. 1, 123 S. Ct. 2058 (2003), a United States Supreme Court case holding that: (1) the National Bank Act defines what constitutes the taking of usury by a national bank, while state law merely determines the maximum permitted rate, and that (2) sections 85 and 86 of the National Bank Act supersede both the substantive and the remedial provisions of state usury laws and create an exclusive federal remedy for overcharges. In reaching its conclusion, the Appellate Court of Illinois stated that the National Bank Act was dispositive and it distinguished certain cases (*Goleta National Bank v. O'Donnell* and *Flowers v. EZPawn of Oklahoma, Inc.*) and an Office of the Comptroller of the Currency interpretive letter cited by the plaintiff (OCC Interpretive Letter #1016, February, 2005). *Goleta* involved the lack of standing on the part of a national bank to intervene on behalf of its state chartered pay day loan agent in an action by a state regulator against the state chartered pay day lender. *Flowers* concerned a non-bank lender's violation of state usury law. And, OCC Interpretive Letter #1016 addressed the non-applicability of National Bank Act preemption to state consumer protection laws against the ultimate owners of loans when a national bank merely acted as trustee for a loan securitization pool, but such bank did not originate or purchase the underlying loans.

It remains to be seen whether other courts will follow the reasoning of the *Dannewitz* court and hold that National Bank Act (or Home Owners Loan Act) preemption of state law applies to residential mortgage loans purchased by a national bank (or federal thrifts), or their operating subsidiaries, when the loan was originated by a non-bank, state chartered lender.

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