FW FarleighWitt Attorneys

Credit Union Executive News

October 30, 2007

FINAL AFFILIATE MARKETING RULE RESTRICTS CREDIT UNION/CUSO MARKETING

Last week the federal banking agencies, including NCUA, issued final rules to implement the affiliate marketing provisions in Section 214 of the Fair and Accurate Credit Transactions Act of 2003 (FACTA).

The final rules generally prohibit a credit union or CUSO from using certain information received from an affiliate (CUSO or credit union) to make a solicitation to a member unless the member is given a written notice and reasonable notice to opt-out of such solicitation. To the extent your credit union and CUSO share member information, through a common database or otherwise, your privacy policies will need to be updated and new operational procedures implemented for the new restrictions. The final rules are effective January 1, 2008 with mandatory compliance by October 1, 2008.

Under the affiliate marketing rules, the members have the ability to limit the circumstances under which a CUSO may use the member's information from the credit union to market CUSO products and services to the member. Similarly, if a CUSO shares member information with the credit union, the member can limit the credit union's use of the member information in marketing credit union's products and services.

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NCUA'S FINAL RULE ON CATASTROPHIC ACT PLANNING

NCUA has issued a final rule that updates various requirements related to Credit Union Vital Records Presentation Program (Part 749) and restoring vital member services resulting from catastrophic act events.

Based on the recovery experience credit unions gained from the disasters of hurricanes Katrina and Rita, NCUA felt it was necessary to update several regulations and to issue "guidance" to assist credit unions in the recovery of essential operations after catastrophic acts.

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AFFILIATE MARKETING (CONT.)

The rules apply to information obtained from the member's transactions, account relationships with an affiliate (credit union/CUSO), an application the member has submitted to the credit union/CUSO and third-party sources, such as a credit report, if the information is used to send marketing solicitations.

The affiliate marketing rules will impact many credit union and CUSO operations, particularly if they share access to a common database. To the extent a credit union and CUSO can access a joint database and either the credit union or CUSO reviews member information and develops marketing solicitations based upon the member information, the affiliate marketing restrictions will apply. However, if there is no joint database access or information sharing between the credit union and CUSO, the affiliate marketing restrictions will not apply.

One issue that was unclear in the proposed rule was which entity was responsible for the notice and opt-out form: the credit union or CUSO? The final rule clarifies that the entity who has the existing relationship with the member must give the notice—typically the credit union. The final rule includes the prescribed notice and opt-out election forms that credit unions and CUSOs will need to provide. These notices may be incorporated into the initial or annual privacy notices of the credit union/CUSO or a jointly issued privacy notice.

While the final rules provide important exceptions for preexisting member relationships with an affiliate, the exceptions may have limited applicability. From a compliance standpoint, credit unions and CUSOs that share member information or databases and conduct marketing solicitations will need to review their information sharing practices, revise their privacy policy notices and develop new operational support to deal with member opt-outs.

Farleigh Witt has developed a comprehensive FACTA compliance program and has recently issued a compliance alert fully explaining the affiliate marketing rules. If your credit union or CUSO needs assistance with compliance issues related to affiliate marketing and privacy notices, please give us a call.

Brian Witt

CATASTROPHIC PLANNING (CONT.)

They key areas of NCUA's final rule include:

- Revised Part 749 – Records Prevention Program and Record Retention – all Sections (749.0-749.6) have been updated and rewritten to incorporate NCUA recommendations for restoring vital member services.
- New Appendix B to Part 749 – Catastrophic Act Preparedness Guidelines – suggested guidelines only, not regulation.
- Updated Part 748 – Catastrophic Act Reports – broadens the term "catastrophic act."

NCUA's final rule became effective September 4, 2007.

Part 749 Records Preservation Program

All federally insured credit unions must have a written records retention program that includes plans for retaining records and safeguarding vital records. These rules have not changed. However, NCUA has rewritten all sections of Part 749 and added a new Appendix B to incorporate recommendations and guidelines for preparing for catastrophic acts.

These new recommendations and guidelines are not regulatory requirements, but they are integrated throughout Part 749 as if they were. Rather than just issue new stand alone (nonregulatory) guidelines for catastrophic acts planning, Part 749 contains regulatory requirements and nonregulatory guidelines.

Catastrophic Act Preparedness Guidelines (Appendix B)

In the new Appendix B to Part 749, NCUA has issued suggested guidelines for credit unions to develop a program for a catastrophic act. NCUA recommends such a program be developed with oversight and approval of the Board.

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CATASTROPHIC PLANNING (CONT.)

The program would address 5 key elements:

- Business impact analysis of potential threats
- Risk assessment of critical systems
- Written plan to restore vital records
- Internal controls
- Annual testing and review

Is a new catastrophic plan really necessary? Probably not. After all, credit unions must have already developed, implemented, and tested comprehensive written Disaster Recovery and Business Contingency Plans (NCUA Letter No. 01-CU-21). In addition, just last year NCUA issued new Disaster Preparedness and Response Examination Procedures (NCUA Letter No. 06-CU-12). Rather than create another new written plan, credit unions should focus on the vital records aspects of the new rule and update record retention plans and disaster recovery programs accordingly. NCUA's new rule is not quite a catastrophe itself but is indicative of NCUA's recent approach to blur the distinction between guidelines and regulation.

Farleigh Witt has developed a very comprehensive Records Management Program for Credit Unions. This Program provides policy and operations guidelines covering the following:

- *Records preservation requirements for compliance with NCUA Part 748*
- *ESIGN compliance requirements for retention of imaged documents and destruction of paper documents*
- *Records destruction and protection guidelines*
- *Records retention schedule for federal and state law*
- *Internal operations forms for records management and organization*
- *Preservation and production of electronically stored information and litigation hold guidelines*

Please give us a call if you need to implement or update your Credit Union's Records Management Program.

Brian Witt

NEW DOD REGULATIONS: INCREASED LOAN DISCLOSURES FOR CREDIT EXTENDED TO SERVICE MEMBERS AND DEPENDENTS

Effective October 1, 2007 the Department of Defense (DOD) issued its long-awaited regulations on credit offered or extended to service members.

The new law will have a significant impact on credit unions offering short-term closed-end loans to members who are on active duty in the service. The new law imposes a new APR calculation and new disclosures for these loans.

Covered Loans. The key to compliance is knowing what loans are covered by the regulation. The regulation covers closed-end credit offered or extended to service members and their family members for one of three purposes:

- Payday loans
- Short term vehicle title loans
- Tax refund anticipation loans

Payday Loans. A payday loan is defined as a closed-end credit transaction having a term of 91 days or fewer, where the amount financed does not exceed $2,000. The definition is limited to transactions where the borrower provides a check or other payment instrument that the creditor agrees to hold, or where the borrower authorizes the creditor to initiate a debit or debits to the covered borrower's deposit account.

Vehicle Title Loans. A vehicle title loan is closed-end credit with a term of 181 days or fewer that is secured by the title to a motor vehicle, registered for use on public roads, and owned by a covered borrower. The lender retains the title to the vehicle until the loan is repaid; the borrower may lose ownership of the vehicle if he or she defaults on the loan.

Refund Anticipation Loans. This is closed-end credit in which the covered borrower expressly grants the creditor the right to receive all or part of the borrower's income tax refund or expressly agrees to repay the loan with the proceeds of the borrower's refund.

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NEW DOD REGULATIONS: INCREASED LOAN DISCLOSURES (CONT.)

Affected Borrowers.

The law defines who is covered by the regulation: Service members on active duty, members of the Guard and Reserve who are on Title 10 orders for more than 30 days, their spouses and children, and individuals who receive at least 50% of their financial support from the service member for 180 days prior to applying for the loan. The regulation allows creditors to ask the borrower if he or she is a covered borrower through a declaration called a "Covered Borrower Identification Statement."

Covered Borrower Identification Statement. If the credit union makes a covered loan, it can use a "Covered Borrower Identification Statement ("CBIS") to determine whether the borrower is covered by the new regulation. The CBIS is a written statement signed by credit applicants to identify if they are included in the definition of covered borrower. It does not require an applicant to specify the exact basis for claiming covered status. If the borrower signs a CBIS indicating that they are not a "covered borrower," the credit union will be deemed in compliance even if the borrower is actually covered by the regulation. To the extent that a loan is not closed-end credit for one of the three applicable purposes, the credit union does not need to obtain a signed CBIS.

New Disclosures. The new law requires a number of new consumer loan disclosures for covered borrowers requesting and obtaining a covered loan.

New Credit Disclosures. The law and the regulation require new disclosures (in addition to the Truth in Lending Act disclosures) to be provided to a covered borrower both orally and in writing. These disclosures include: (i) the MAPR (see below), (ii) a required statement about alternative sources for financial assistance and emergency funds, and (iii) an explanation of the payment obligation schedule. The applicable TILA disclosures must be in writing only.

New Military Annual Percentage Rate (MAPR)

The Military Annual Percentage Rate (MAPR) is the cost of the consumer credit transaction expressed as an annual rate, much like the annual percentage rate currently required to be disclosed by a creditor. currently required to be disclosed by a creditor under Regulation Z. However, the MAPR also includes other fees and charges that currently are not included in the annual percentage rate under Regulation Z. The Military Annual Percentage Rate includes administrative and membership fees, insurance, and other fees known at the time the loan is signed and obligated. The DOD rule prohibits an MAPR that exceeds 36%. Thus, if a covered loan includes credit insurance and/or other fees, it could limit the interest rate that the credit union could charge.

The new regulations became effective October 1, 2007.

If you have any questions about the regulation or disclosures, please call us.

Hal Scoggins

FFIEC UPDATES BSA COMPLIANCE MANUAL

On August 24, 2007, the Federal Financial Institutions Examination Council (FFIEC) released an updated Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual. The BSA manual has been updated through the joint efforts of FinCEN and the federal banking agencies including NCUA to provide current and consistent guidance on policies, procedures and processes to comply with the BSA.

The FFIEC made revisions throughout the manual. The more significant updates affecting credit union operations include:

- **Member Due Diligence –** Clarified regulatory expectations between lower-risk and higher-risk members.

- **Suspicious Activity Reporting** – Enhanced discussion of law enforcement inquiries and requests. New guidance on maintaining accounts and supporting documentation.

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FFIEC UPDATES (CONT.)

- **OFAC** – Revised and clarified guidance on screening responsibilities in connection with automated clearing house (ACH) transactions.

- **Electronic Banking** – New guidance regarding Remote Deposit Capture.

- **Trade Finance** – Clarified regulatory expectations, refined definitions, and enhanced the discussion of risk mitigation practices.

- **Non-Bank Financial Institutions** – Expanded the discussion on providing banking services to money services businesses.

- **Money Laundering and Terrorist Financing "Red Flags"** – Expanded examples of red flags for trade finance, ACH transactions, shell company activity, and other potentially suspicious activity, and added new examples for lending activity.

Enforcement Guidance – Added recently issued interagency enforcement guidance addressing noncompliance with BSA/AML requirements.

BSA compliance is a significant compliance cost center for credit unions. However, we believe the FFIEC Manual continues to be an excellent resource that allows credit unions to avoid expensive BSA seminars and access the tools necessary to achieve effective BSA compliance.

Farleigh Witt provides extensive BSA compliance support including BSA audits and the most comprehensive written BSA /AML Program available for credit unions. Feel free to call us if you need BSA support.

Brian Witt

Who stands behind your Credit Union compliance?

FINAL RED FLAG RULES ADOPTED

The NCUA, FTC, and other federal regulators have at last adopted the final "red flag" guidelines and address reconciliation rules under the Fair and Accurate Transactions Act ("FACTA"). The rule imposes three new requirements on credit unions under FACTA: (1) development and implementation of an identify theft program (the "red flag" rules); (2) required response to notices of address discrepancy received from credit report agencies; and (3) response to address change requests from credit and debit card account holders. Depending on when they are published in the Federal Register, the new rules may become effective as early as January 1, 2008. *However, compliance is optional until November 1, 2008.*

Identity Theft Program

The most significant part of the new rules requires each credit union to maintain an identity theft program. The program will include policies and procedures to: (1) identify relevant "red flags" – i.e., signs of likely identity theft; (2) detect the existence of red flags in member relationships; (3) respond to red flags as necessary to prevent and mitigate identity theft; and (4) update the program periodically. The program should be tailored to the size and complexity of the credit union's operations, account offerings and field of membership. The program must be approved by the board of directors or a committee of the board, and the board (or a board committee or senior management) must be involved in the oversight and administration of the program. The program must include oversight of service provider arrangements as necessary to implement the credit union's program. The final rules include some adjustments from the proposed regulations, designed to allow institutions greater flexibility in designing and implementing identity theft programs tailored to their specific needs. Federal credit unions are subject to the NCUA's rule, while state credit unions are subject to the identical FTC rule.

Address Discrepancies

FACTA also required the FTC to impose duties on users of consumer credit reports who receive a "notice of address discrepancy" ("NAD") from a consumer reporting agency.

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RED FLAG RULES (CONT.)

The new FTC rules require that when a credit union receives a NAD, the credit union must use reasonable policies and procedures to enable it to be reasonably sure that the consumer report does in fact relate to the consumer the credit union has inquired about. The credit union must also furnish the reporting agency with an address that the credit union has confirmed is correct if the credit union: (a) establishes an ongoing relationship with the consumer, (b) is reasonably sure that the consumer report relates to that consumer, and (c) routinely reports on account holders to the consumer reporting agency.

Address Changes for Credit and Debit Cards

The final piece of the new rule requires a credit union to take precautionary measures when an address change request for a credit or debit card account is followed shortly by a request for a replacement card or additional card on the same account. In such cases, the credit union cannot issue the new card until it has: (1) notified the cardholder at the cardholder's former address or by any other means of communication that the credit union and the cardholder have previously agreed upon (i.e., e-mail); and (2) allowed the cardholder a reasonable opportunity to report that the address change was incorrect. As an alternative to these measures, the credit union may otherwise validate the change of address in accordance with policies and procedures established under its identity theft program.

Farleigh Witt has developed a comprehensive FACTA compliance program and has recently issued a compliance alert explaining the new red flag, address discrepancy, and card address change rules. If your credit union needs assistance with FACTA compliance issues, please give us a call.

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FRB RELAXES TERMINAL RECEIPTS FOR SMALL TRANSACTIONS

Earlier this summer the Federal Reserve Board (FRB) revised Regulation E to relax the requirement for providing transaction receipts for transactions of $15 or less. This change was made to accommodate merchants who had difficulty providing the type of POS terminal receipts otherwise required under Reg. E. The FRB did not just carve out low dollar POS transactions from the terminal receipt rule, the exception applies to all electronic transactions at electronic terminals, including ATM withdrawals. The FRB declined to change the model EFT disclosure language regarding terminal receipts. However, we recommend you review your EFT agreements and disclosures and consider an update at your next reprinting.

Brian Witt

NEXT MONTH . . .

The November *Credit Union Executive News* will cover a number of additional recent developments that will have a significant impact on credit unions:

NCUA – Member Access to Records Rule for FCUs – NCUA overreacting with overkill corporate governance rules?

NCUA – Increased Regulation of FCU Bylaws – The latest in a series of NCUA actions to increase the regulatory grip on corporate governance of FCUs.

Truth-in-Lending – Sweeping changes to credit card and open-lending disclosures proposed by the FRB. Does this really wipe out open-end lending for credit unions?

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