

# UPDATE

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## News of Developments in the Financial Sector and Related Areas

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### *Guidance on Customer Identification Regulations*

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### *Guidance on Customer Identification Regulations*

The Federal Banking Regulatory Agencies and the Department of the Treasury have issued questions and answers in the form of *frequently asked questions* ("FAQs") which are designed to help institutions comply with the Customer Identification Rule issued under the USA Patriot Act. The FAQs cover a host of issues including how a bank can demonstrate that it has a reasonable belief that it knows the true identity of a person with an existing account and how an institution may exclude from the definition of "Customer" a person that has an existing account with its affiliate. The FAQs also cover the required records that an institution must obtain and the length of time that these records must be maintained. The FAQs should be of substantial assistance to an institution in complying with the requirements of the USA Patriot Act. The FAQs are available on the web site of the Financial Crimes Enforcement Network at [www.fincen.gov](http://www.fincen.gov).

### *Directors and Officers Liability Insurance*

With new laws such as the Sarbanes-Oxley Act which requires, among other things, certain companies to set up independent

audit committees and independent directors to take on a more active governing role, it is important to consider the need for directors and officers liability insurance coverage. This is particularly true in the case of the number of personal liability suits and the value of the settlements in connection with these suits which continues to escalate each year. Generally, directors and officers liability insurance protects directors and officers against losses resulting from suits for an allegedly "wrongful act." A wrongful act may include such things as the failure by a director or an officer which results in damage to the company. When purchasing directors and officers liability insurance coverage, it is especially important to understand the coverage limits and the exclusions contained in the policy. In some instances it may be necessary to consider a rider to the policy in order to cover specific areas and activities. It is particularly important to make sure that the application for coverage is completed accurately and in detail.

### *Things Are Heating Up Regarding Regulation of National Banks*

The New York Attorney General, Eliot Spitzer, has filed a lawsuit against First Horizon Mortgage Loan Corp., a subsidiary of First Tennessee Bank, alleging false and deceptive business practices in violation of state law in connection with a mortgage loan to a New York resident. The lawsuit was apparently filed in connection with final regulations of the Office of the Comptroller of the Currency ("OCC") in which the OCC takes the position that state laws are preempted by federal law and it has exclusive authority over national banks and their subsidiaries. Recently, a number of subsidiaries of federal savings banks and national banks, relying on federal banking regulatory agencies and their

interpretation that federal law preempts regulation by the state regulatory authorities, have begun offering loans which otherwise may not comply with the requirements of state law. Information on the final regulations issued by the OCC is on the *Update* web site at [www.GWBinns.com](http://www.GWBinns.com) by clicking on *Update Archives* in the January 2004 issue under the heading entitled *Regulation of National Banks by States*.

### ***Cases, Releases and Rulings***

The Office of the Comptroller of the Currency ("OCC") recently published final rules which will allow a national bank to reorganize directly to become a subsidiary of a bank holding company; to increase the maximum term of service for national bank directors; to permit a national bank to adopt bylaws allowing for staggered terms for directors; to permit national banks to apply for permission to have more than 25 directors; and to permit national banks to merge with one or more of their nonbank affiliates. The final rules allowing national banks to make the new organizational changes is available on the web site of the OCC at [www.occ.treas.gov](http://www.occ.treas.gov).

In *Securities & Exchange Commission v. Edwards*, 540 U.S. \_\_\_\_ (2004), the United States Supreme Court held that payphone sale and leaseback agreements were securities in the form of investment contracts and subject to regulation under federal securities laws. 10,000 people had invested approximately \$300 million in the leaseback arrangement. The purchase price for the payphone packages was approximately \$7,000 and in return, each purchaser was to receive \$82 per month, plus a 14% annual return under the leaseback arrangement, in addition to refund of the full purchase price of the package at the end of the lease or within 180 days of a purchaser's request. Because the payphones did not generate enough revenue to make payments required under the leaseback agreements, funds to pay purchasers depended on funds from new

investors. The Court noted that there was no reason to distinguish between an agreement involving a fixed rate of return such as the leaseback arrangement and an agreement involving a variable rate of return for purposes of determining a security under federal law.

Recently, the Fair and Accurate Credit Transactions Act of 2003 (the "FACT Act") was enacted which permanently extends the expiring preemptions of the Fair Credit Reporting Act that blocks states from interfering with how businesses use, share and report information about the credit of their customers. The FACT Act will require that customers be given a free credit report every year and have the right to see their credit scores. It also requires merchants to stop printing credit and debit account numbers on electronically printed receipts. The FACT Act requires notification to customers if negative data is sent to a credit bureau or credit is granted at worse terms than generally available. Among other things, it will require regulators to issue guidelines for compliance by financial service companies in detecting identity theft.

The Federal Reserve Board has issued a proposed rule to implement the *Check Clearing for the 21<sup>st</sup> Century Act* (the "Check Clearing Act") which was recently signed into law and will become effective on October 28, 2004. The Check Clearing Act authorizes a new negotiable instrument called a "substitute check" that is the legal equivalent of the original check for all purposes. A substitute check is a paper reproduction of the original check that can be processed just like the original check. The proposed rule provides a model disclosure and model notices relating to substitute checks and sets forth bank endorsement and identification requirements for substitute checks. The proposed rule also sets forth how consumers can file a recredit claim within 40 days of a check's date in the event the consumer feels that there has been a mistake.