

August 31, 2001

Office of the Comptroller of the Currency
Public Information Room
250 E Street, N.W.
Third Floor, Mail Stop 1-5
Washington, D.C. 20219
Attention: Docket No. 01-15

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th and C Streets, N.W.
Washington, D.C. 20551
Attention: Docket No. R-1105

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Docket No. FR01-17888,
Comments/OES

Manager, Dissemination Branch
Information Management and
Services Division
Office of Thrift Supervision
1700 G Street, N.W.
Attention: Docket No. 2001-41

Re: Study of Banking Regulations Regarding the Online Delivery of
Financial Services

Dear Madams and Sirs:

The Electronic Financial Services Council (“EFSC”)¹ appreciates the opportunity to respond to the requests for comments issued by the Federal Reserve Board (“FRB”), the Office of the Comptroller of the Currency (“OCC”), the Office of Thrift Supervision (“OTS”) and the Federal Deposit Insurance Corporation (“FDIC”) (collectively, the “banking agencies”) in connection with their respective studies of banking regulations regarding the online delivery of financial services. The banking agencies are required by Section 729 of the Gramm Leach Bliley Act to study their respective regulations regarding the online delivery of financial services and report to Congress their findings and any recommendations for regulatory or legislative action to better facilitate the online delivery of financial services.

The EFSC commends the banking agencies for undertaking these studies and for their efforts to date to review and revise their regulations to better accommodate new electronic commerce technologies and new business strategies in the financial services industry. The members of the EFSC have experienced significant expense, delay and frustration in their efforts to offer their

¹ The EFSC is an organization representing many of the leading companies offering financial services over the Internet. The Council’s mission is to update laws and regulations to facilitate the electronic delivery of financial services (including mortgages, insurance, real estate, on-line banking services, and securities). Members include: Countrywide Home Loans, Inc., Intuit Inc., GE Capital Mortgage, Microsoft Corporation, Cendant Mortgage, Chase Manhattan Mortgage, Citigroup Mortgage, Inc., Fannie Mae, Freddie Mac, GMAC Mortgage Corporation, Lender Services, Inc., Lending Tree, The Principal Financial Group, United Guaranty Insurance, and Wells Fargo, and Esurance. Additional information about the EFSC is available on the Internet at www.efscouncil.org.

products to consumers via the Internet as a result of a variety of “legacy” laws and regulations designed to facilitate face-to-face, paper-based transactions, but which now stand as barriers to the electronic delivery of financial services. Although there has been significant progress in removing one of the largest impediments to financial services, the need for paper documents and pen-and-ink signatures, through the passage of federal electronic signature legislation, much remains to be done. The EFSC appreciates the opportunity to participate in the current effort of the banking agencies to study and identify areas of law and regulation that should be revised, repealed or reworked to improve the online delivery of financial products and services.

The banking agencies have raised a variety of issues in their respective requests for comment, many of which are substantial similar. The following are the EFSC’s comments on some of the specific issues and questions presented by the agencies.

Electronic Signatures

The banking agencies have asked whether it is appropriate for them to issue regulations or other supervisory guidance to set forth standards for the use of electronic signatures and records pursuant to the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. § 7001 *et seq.* (“E-SIGN Act”).

The EFSC believes that as a general matter the rules set forth in the E-SIGN Act have tremendous promise for facilitating the online delivery of banking and other financial services. In consumer transactions, the E-SIGN Act addresses the need of consumers to obtain information before agreeing to receive legally mandated disclosures as electronic records. While the EFSC believes that certain provisions of the E-SIGN Act could stand improvement, particularly those relating to the timing and methodology for delivering disclosures mandated by the E-SIGN Act in connection with consumer consent,² it is premature, unnecessary and, perhaps inappropriate, for the agencies to issue regulations or other supervisory guidance on these aspects of the E-SIGN Act.

The E-SIGN Act establishes a series of specific procedures that must be followed before a federal agency has authority to issue regulations interpreting the E-SIGN Act. As noted in our comment to the Board regarding its interim rules concerning the use of electronic communications to provide required notices under five consumer protection regulations (i.e., regulations B (Equal Credit Opportunity Act), E (Electronic Fund Transfers), M (Consumer Leasing), Z (Truth in Lending), and DD (Truth in Savings)), the EFSC is concerned that regulations may be issued which, while helpful in providing practical solutions to important problems with implementing electronic records and signatures, may have the unintended effect of creating future legal uncertainty for financial service providers by circumscribing the procedural requirements of the E-SIGN Act and misinterpreting provisions of the Act.³

² As further background on the EFSC’s position regarding the E-SIGN Act in general and the consumer consent provisions in particular, we have attached copies of the EFSC’s comments to the Federal Trade Commission and National Telecommunications and Information Administration and its testimony before the House Financial Services Subcommittee on Domestic Monetary Policy, Technology and Economic Growth as Exhibits A, B, and C.

³ See the EFSC’s comment to the Board, attached as Exhibit D.

Accordingly, while the EFSC reiterates its previous comments regarding the E-SIGN Act as set forth in the attached materials, and would urge the banking agencies to recommend that Congress consider appropriate technical corrections to the E-SIGN Act, we believe that regulations or other supervisory guidance interpreting the E-SIGN Act are not warranted at this time.

Differing Legal Requirements

The federal banking agencies have asked whether there are particular aspects of conducting online banking and lending activities that could benefit from a single set of legal standards that can be applied uniformly nationwide.

As a general matter, the EFSC supports the creation of clear, consistent and uniform standards for regulating financial services given the increasing national and international character of the financial services industry in the 21st century. Indeed, the EFSC strongly supported inclusion of provisions in the E-SIGN Act to ensure that it creates a nationwide minimum standard for the use of electronic records and signatures. The EFSC is concerned that there are several areas in which there is a significant risk that the states, and in some cases local governments, will adopt a patchwork of laws that will impede not only the online delivery of financial services, but the ability of financial institutions generally to offer products and services on a nationwide basis. In particular, the EFSC is concerned with the possibility that states will adopt laws addressing the information sharing practices and lending operations of financial institutions under the guise of consumer privacy and predatory lending laws in a manner that makes compliance unduly complicated and costly and operations impractical. Already, we have seen several financial institutions abandon significant market segments as a result of unworkable, over reactive and non-uniform state laws. The EFSC urges the banking agencies to recommend that Congress adopt legislation providing for a single national standard on these and other important issues that run to the heart of the operations of national and regional financial services firms.

With respect to privacy legislation, we note that even before there has been an opportunity to assess the impact of the privacy provisions of the Gramm Leach Bliley Act, states are proposing additional privacy requirements. For the reasons described above, we believe that a patchwork of state privacy requirements will inhibit the electronic delivery of financial services. The issues surrounding privacy are not only emotional, but more complex than they would at first appear. The Council believes that there are strong arguments for adopting national standards regarding privacy and for placing a moratorium on state enactments until there is an opportunity for a thorough consideration of all the aspects of this complex issue at the federal level. This is an area where the promotion of interstate and international commerce, in our view, requires a uniform national policy.

The Need for Uniformity of Licensing Requirements

The banking agencies also have asked whether there are any state laws or regulations, such as licensing provisions for banking and other financial products and services, that affect the nationwide provision of financial products or services over the Internet. In the experience of members of the EFSC, state licensing requirements are becoming increasingly burdensome and

costly, inhibiting the ability of financial institutions to offer their products and services to consumers nationwide.

By transmitting information over the Internet, a company may, from a single location, enter into a consumer transaction in any and every state. A threshold question is whether the transaction occurs in the state in which the consumer is located, or at the location from which the electronic message originated (which may not necessarily be where the company transmitting the message is physically located and licensed). Most states that we have encountered believe that the transaction is deemed to occur in the state where the consumer is located. Also, in some cases, such as residential mortgage loan transactions, state jurisdiction follows from the situs of the property securing the loan, even if neither the borrower nor the lender are residents of the situs state. As a result, insurance companies, mortgage brokers, mortgage lenders, and real estate brokers are typically required to obtain separate licenses or other regulatory approvals in each state in which they do business.

While the difficulties associated with 50 or more different licensing laws predate the existence of the Internet or the conduct of business by electronic means, the ease of access to a nationwide market made possible by new technologies such as the Internet heightens the need for greater uniformity in the licensure and regulation of financial service providers. The Gramm Leach Bliley Act of 1999 was an important step towards the elimination of unnecessary and unduly burdensome regulatory barriers for the banking and securities sectors of the financial industry. The EFSC believes similar progress must be achieved in the mortgage, insurance and real estate industries.

For example, the regulations governing the brokering, making, and servicing of residential mortgage loans, home equity loans and consumer loans vary significantly from state to state. Each state has at least one, and in some cases two or more licensing laws applicable to the mortgage business. There is no consistency of definitions of the activities subject to licensing or the categories of companies eligible for exemption from licensing. A company doing business on the Internet seeking to become licensed to offer first and second mortgage loans in all 50 states and the District of Columbia must complete 50 to 75 separate license applications, obtain multiple surety bonds, provide similar corporate, personal and financial information on its officers, directors, and investors on separate forms for each state, and undergo extensive and repetitive background investigations. Although each state reviews roughly the same information when considering license applications, there is no uniformity with respect to how the information is gathered, processed or analyzed, nor is there an effective system by which states can access the information obtained by other states to reduce the redundancies of the current system.

As a result of the inefficiencies of the multi-state licensing process, a company seeking national lending authority may require up to a year or more to obtain all the licenses required to operate. The direct cost of this process is significant as well, running as much as \$500,000 or more in terms of state filing fees, bond premiums, auditors' fees, registered agent expenses, and legal fees. The indirect costs associated with the current multi-state licensing system, such as the diversion of extensive corporate and administrative resources and the opportunity costs resulting from the lengthy time to obtain nationwide authority to conduct business, are more difficult to quantify, but are undoubtedly significant as well. Corporate officers, directors and investors can

expect to be called upon repeatedly to provide detailed personal, business and financial information, and to provide fingerprints for multiple criminal background investigations. In addition, once licenses are obtained, companies must incur significant costs and devote substantial administrative resources for functions related to the upkeep of licenses, including annual license renewal procedures, the completion of annual reports of lending activity and financial results, general regulatory compliance and management of state examinations, and the payment of annual fees and assessments.

To address these concerns, and reduce the substantial barriers to online delivery of financial services presented by the current system of multi-state regulation, the EFSC suggests that the banking agencies consider the feasibility of a federal non-depository financial institution charter. A federal non-depository financial institution charter could be available as an alternative to, and not a replacement of, the current system of state licensure and regulation of non-bank financial services providers. The advantages of such a charter to consumers and companies offering financial products online would be clear: companies could obtain authority to do business nationwide, and be subject to supervision and oversight, by a single, federal regulator. This would eliminate a substantial impediment to the online delivery of financial services throughout the country, while at the same ensuring consumer protection via a strong regulator and expanding access to financial services to consumers located in inner cities, rural areas and other under served markets. Moreover, because the charter would not involve deposit insurance, safety and soundness concerns would be minimized and taxpayers would not bear the risk of loss.

Alternatively, legislation could be enacted to encourage states to adopt, within a specified time period, uniform licensing laws or a system of reciprocity under which a license issued in one state is recognized in other states, provided that the laws applicable in the “home state” of the licensee meet a minimum threshold standard of regulation and oversight. Unless a significant majority of states adopt either a uniform licensing law or provide reciprocity for licenses issued in other states, it would be appropriate for a federal licensing system to be implemented to ameliorate the significant barriers to electronic commerce resulting from the current multi-state licensing system. A precedent has been set in the insurance industry for a mechanism to encourage states to adopt a uniform, national licensing system for persons who sell or solicit the purchase of insurance. The Gramm-Leach-Bliley Act contains provisions (see Sections 321-336) that require states to act within three years either to adopt uniform licensing laws or to enact reciprocity laws governing the licensing of nonresident insurance agents. If a majority of states fail to act within three years, a national registration scheme, known as the National Association of Registered Agents and Brokers (“NARAB”), will be implemented. An insurance agent who registers with NARAB would be able to be licensed in any state without regard to state residency requirements so long as the agent pays the requisite license fees and meets applicable bonding requirements. The EFSC suggests that consideration be given to extending the NARAB model to other segments of the financial services industry, such as mortgages and real estate, that are plagued by similar licensing inefficiencies inherent in the current non-uniform, multi-state licensing system.

In-State "Bricks and Mortar" Office Requirements are Unconstitutional and Clear Barriers to Electronic Commerce

In several segments of the financial services industry, a host of state laws exist which require financial service providers to maintain offices in state or employ local residents as employees or agents. While some of these laws are legacies of an era where it was valid to assume a transaction would occur in person, others were clearly intended to restrict out-of-state competition. The EFSC believes it is appropriate for the federal government to exercise its authority to regulate interstate commerce and block enforcement of these state laws that unduly burden commerce among the states and which are antithetical to the concept of the Internet as an electronic marketplace free of the expense and inconvenience of physical places of business.

In the mortgage industry, approximately 30% of states require companies that make, broker or service first or second lien, residential mortgage loans to maintain some form of in-state office as a condition for becoming licensed. Among the states with these so called "bricks and mortar" requirements are Arizona, California, Georgia, New Jersey, Ohio, Pennsylvania, and South Carolina. In-state office requirements no longer serve any legitimate public policy object, such as consumer protection, and impose an undue burden on interstate commerce in the mortgage industry. Requirements for companies to maintain offices or employees in a particular state cannot be justified by business necessity and are out of sync with new technologies and business models that permit the accurate, convenient, and efficient communication of information to consumers via the Internet, centralized call centers and express mail.

Without discussing the specific bricks and mortar rules for each state, it is useful to consider the requirements in South Carolina's mortgage broker statute as an example of the burden these requirements impose on all mortgage companies operating nationally from centralized locations, using the Internet or other communications media. South Carolina law requires that a licensed mortgage broker maintain a physical place of business in the state, which, at a minimum, is staffed by at least one employee with authority to contract on behalf of the licensee and to accept service of process on the broker. The office must be open during regular business hours, which are defined as at least 30 hours a week from Monday through Friday. The state regulator must be notified of the licensee's hours of operations if the licensee's office is not open for business from at least 8:30 am to 5:00 pm, Monday through Friday.

While requirements in other states are not as well defined or onerous, the mere necessity of a physical presence in a state is a significant burden for companies doing business through electronic commerce. Companies are forced to either incur the cost of leasing offices, hiring employees and paying for equipment that they do not need and would not use but for the fact of the bricks and mortar requirement, or elect not to do business in that state. Either way, consumers are the ones that ultimately suffer as there are fewer sources of capital and less competition among lenders; and those out-of-state lenders that elect to do business in the state must incur greater expenses and do business at a competitive disadvantage, with the likely result being higher costs for consumers.

Unfortunately, in many states, the bricks and mortar requirements are not merely a case of old laws needing to be brought up to date. In the past three years, a number of states, including

Alabama, Georgia, Kansas, Ohio, Texas and Wisconsin, have adopted some form of in-state office requirement for mortgage companies. In many cases, these laws are the result of lobbying efforts by local mortgage companies with the express purpose of limiting competition from lenders and brokers operating on the Internet or otherwise from out of state.

With respect to insurance sales, many states still require that a resident agent countersign policies issued by agents or insurers not domiciled in the state. Some states also have laws or other requirements that specify that a nonresident agent or producer must be accompanied by a resident producer to solicit insurance. Countersignature requirements and resident-nonresident “hand holding” requirements clearly impede the sale of insurance through electronic means and serve only as a protection of resident agent commissions.

In addition to the fact that there is no reasonable business or public policy justification to support the continuation of in-state office or resident agent requirements, a compelling legal case may be made that a state law mandating that a company operate an office in-state or employ a state resident as a condition of becoming licensed or operating in the state violates the Commerce Clause of the Constitution of the United States.

It is well settled that a state law that discriminates on its face or in its effect by treating in-state and out-of-state commerce or competitors differently is per se invalid under the Commerce Clause. *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979); *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 274 (1988). A state law that discriminates in favor of local interests to the detriment of out-of-state businesses “invokes the strictest scrutiny of any purported legitimate local purpose, and of the absence of nondiscriminatory alternatives” and will generally be upheld only if it is the least restrictive means available to achieve a legitimate local government objective. *Hughes v. Oklahoma*, 441 U.S. at 337.

Federal courts considering the validity of in-state office requirements in connection with professional licenses have consistently struck down requirements that companies maintain an office in the subject state as a condition for holding a license. See, e.g. *Codar, Inc. v. Arizona*, No. 94-16902, 1996 U.S. App. LEXIS 21356 (9th Cir. 1996) (collection agencies); *Georgia Association of Realtors v. Alabama Real Estate Commission*, 748 F.Supp. 1487 (M.D. Ala. 1990) (real estate brokers); *Underhill Assoc., Inc. v. Coleman*, 504 F.Supp. 1147 (E.D. Va. 1981) (securities dealers). Indeed, the Supreme Court has noted that state laws requiring business operations to be performed in-state that could be performed more efficiently elsewhere are virtually per se illegal. See, e.g., *Pike v. Bruce Church*, 397 U.S. 137, 145 (1970).

The EFSC urges the banking agencies to recommend that Congress enact legislation to remove these unconstitutional, protectionist barriers to electronic commerce by expressly preempting state requirements for in-state office and resident agent requirements for mortgage companies, insurance companies and other financial services providers.

Appraisals

The banking agencies have asked whether the requirement for written appraisals impairs or impedes online lending operations. To the extent that there is any doubt as to the ability of an

electronic appraisal to substitute for a written appraisal, the EFSC believes that this issue has been clearly addressed by the adoption of the E-SIGN Act. The E-SIGN Act provides that with respect to any transaction in or affecting interstate commerce, a signature, contract or other record relating to such transaction may not be denied legal effect, validity or enforceability solely because it is in electronic form. Clearly, an appraisal is a record relating to a transaction – an appraisal is typically required by lenders, if not by regulation, as a condition of making a mortgage loan. Thus, because the E-SIGN Act permits the use of an electronic record wherever a writing is required, there is no need for the agencies to provide guidance on how electronic appraisals can be utilized in connection with lending transactions. Furthermore, the Appraisal Standards Board (“ASB”) of the Appraisal Foundation (overseen by the Appraisal Subcommittee of Federal Financial Institutions Examination Council (“FFIEC”)) issued a Statement on the Electronic Transmission of Reports (statement 8) in July 1995. This has been the "regulatory" acknowledgment that appraisals could be transmitted electronically subject to certain protections: essentially that the appraiser performed an act (similar to a signature) that indicated that he or she accepted/adopted the work as his or her own and that he or she was assured that the appraisal was transmitted and received in its original form. The ASB has recently withdrawn that statement, not because they disapproved of electronic transmissions, but felt that the practice was well enough established that the statement might be more of a hindrance than an encouragement (or a bar to future changes in technology).

The agencies have also sought comment on whether additional regulatory guidance is needed with respect to authentication of an electronic appraisal, certification of the appraiser, or other standards regarding the authenticity and integrity of electronic appraisals. The EFSC believes that the recent guidance issued by FFIEC regarding authentication in an electronic banking environment creates a reasonable and flexible standard that should be applied expanded and applied to cover financial institutions’ electronic communications with vendors, including providers of electronic appraisals.⁴

Finally, the EFSC recommends that the banking agencies consider through the FFIEC a separate process to review the feasibility of certain property valuation models as an alternative to an appraisal performed by a licensed or certified appraiser. New, automated property valuation tools are increasingly being utilized as part of automated underwriting systems to assist lenders and investors in making decisions to extend credit or purchase loans. Typically, the cost of these alternative valuation methods is substantially less than an appraisal. In light of the potential cost savings to consumers, the banking agencies should consider whether and under what circumstances these valuation tools should be permitted as a substitute for a full appraisal performed by a licensed or certified appraiser.

Weblinking

Finally, the banking agencies have requested comment on whether various weblinking or hyperlinking arrangements create consumer confusion and whether further regulatory guidance is required. In the typical case, a financial institution may provide hyperlinks from its website to websites of affiliated or non-affiliated third parties that offer financial and/or non-financial

⁴ See FFIEC, *Authentication in an Electronic Banking Environment* (August 8, 2001).

products or services not otherwise offered by the institution as a means of providing users of its website access to a wider array of products or services.

While the EFSC acknowledges that the possibility of consumer confusion always exists, responsible institutions have significant incentives to avoid any misunderstanding over which entity provides which products and services. From a legal perspective, a financial institution providing weblinks would be wise to avoid any characterization that it is offering or endorsing the product or service available through the link, not only to prevent claims of liability for the product or service itself, but also to avoid questions regarding its licensing authority to broker products offered at a linked website, such as mortgages, insurance or securities. In addition, financial institutions have a significant reputational and customer relations interest in making clear their limited role when providing weblinks as they do not want to be viewed by their customers or the public as guarantors of the quality of products and services offered by third parties. Accordingly, absent an empirical showing of actual consumer confusion or harm, the EFSC believes that regulation of weblinking arrangements is not warranted at this time.

The banking agencies request for comment on weblinking highlights another concern, which is the need for consistency among federal agencies when dealing with new electronic commerce issues. The financial services industry has been awaiting guidance for many years from the Department of Housing and Urban Development (“HUD”) on the applicability of the Real Estate Settlement Procedures Act (“RESPA”) to many aspects of the Internet, including weblinking arrangements. The EFSC is concerned that the various statements by the OCC over the years, including most recently its proposed rule and supervisory guidance that define weblinking as a “finder” activity permissible of national banks may have the unintended effect of prejudicing consideration of weblinking arrangements under RESPA. In particular, there are substantial questions as to what type of weblinks and under what circumstances such arrangements might constitute a “referral” of real estate settlement service business for which no fees may be paid may be paid under RESPA. The EFSC urges the banking agencies to exercise caution when reviewing emerging electronic commerce business practices and consider the implications of their regulations on other laws outside their immediate interpretative jurisdiction. When appropriate, the banking agencies should consult with other federal agencies, such as HUD or the Federal Trade Commission, to ensure greater consistency and uniform treatment of a particular business practice.

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The EFSC appreciates this opportunity comment on many of the important issues and questions raised by the banking agencies in connection with their studies of regulations regarding online delivery of financial services. Please contact Jeremiah S. Buckley or John Kromer at (202) 974-1000 with any questions.

Sincerely,

/SIGNED/

Jeremiah S. Buckley

