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SUBJECT: Understanding the Compliance Obligations of Mortgage Lenders, Brokers, and Servicers Under the New Federal Financial Privacy Rules

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Mortgage servicers soon will be undertaking the arduous and costly process of preparing and mass mailing written consumer disclosures required under new federal financial privacy rules to over 51 million customers of first-lien home mortgages and countless millions more of second-lien, home equity, home improvement, and reverse mortgage loans across the country as an initial step of compliance with Title V of the Gramm-Leach-Bliley Act of 1999 (the "G-L-B Act") that must be completed by a mandatory compliance date of July 1, 2001.

Generally, Title V of the G-L-B Act and its implementing regulations govern the treatment by financial institutions of non-public personal information about individuals who obtain a financial product or service from the financial institution that is to be used for personal, family or household purposes. The new federal financial privacy rules restrict the circumstances under which a financial institution may disclose non-public personal information about a consumer or customer to non-affiliated third parties and requires the financial institution to make both initial and annual written disclosures to all its customers about its privacy policies and practices regarding their sharing of financial information with both affiliates and non-affiliated third parties. Before disclosing non-public personal information to non-affiliated third parties in most instances, furthermore, the law requires the financial institution to provide consumers notice and a non-burdensome method by which they individually may elect to "opt out" and thereby prevent the financial institution from making the intended disclosure of information about them. Financial institutions are expressly prohibited by the G-L-B Act from disclosing non-public personal information to unaffiliated third parties unless these notice requirements have been satisfied and the consumer has not elected to opt out.

Mortgage lenders and their mortgage brokers, correspondents, and loan servicers are defined as "financial institutions" subject to these new federal financial privacy laws just like banks, savings associations, and other depository institutions customarily thought of as financial institutions, The coverage of the privacy protections under the G-L-B Act is so broad in fact as to include any business significantly engaged in financial activities, which may be as diverse in many cases as finance companies, leasing agents, real estate appraisers, debt collectors, credit bureaus, title and other loan settlement agents, investment and financial advisors, (including credit counselors and tax preparers), and computer software companies processing and transmitting financial data — even businesses printing and selling bank checks, couriering bank instruments, wiring funds, or selling money orders, savings bonds, or traveler's checks.

Most mortgage lenders, mortgage brokers, and mortgage loan servicers, and other non-depository financial institutions (including non-federally insured credit unions), will be regulated by the Federal Trade Commission (FTC) under its Final Rule published May 24, 2000, in the Federal Register at 65 F.R. 33646 and codified at 16 CFR Part 313 (the "Privacy Rules"), which implements Title V of the G-L-B Act. National and state chartered banks, savings associations, and federally insured credit unions, and subsidiaries of these depository institutions engaged in mortgage lending, brokerage, or servicing are separately regulated by the particular

federal agency having functional regulatory authority over each under substantially identical rules recently adopted by each of the regulatory agencies. This article provides a brief overview of the substantive provisions of the Privacy Rules and assesses how the rules affect the policies and practices particularly of mortgage bankers, mortgage brokers, and loan servicers.

Limits on Disclosure of Non-Public Personal Information

Mortgage lenders and other financial institutions are prohibited under the G-L-B Act and the Privacy Rules from disclosing any *non-public personal information* about a consumer to a non-affiliated third party unless (1) the financial institution has first provided the consumer an initial privacy notice and so-called "opt out" notice in accordance with the Privacy Rules, has given the consumer a reasonable opportunity to opt out, and the consumer does not opt out, or (2) the disclosure of non-public personal information is authorized by one of several express exceptions that are not subject to the consumer's opt out right (the "Permitted Exceptions").

Non-public information means any personally identifiable financial information that a consumer provides to the financial institution to obtain a financial product or service, or information about a consumer resulting from any transaction involving a financial product or service between that same financial institution and the consumer, or information the financial institution otherwise obtains about the consumer in connection with its providing a financial product or service to that customer. The term also includes any list, description, or other grouping of consumers (and publicly available information pertaining to them) that is derived from using any of this personally identifiable information that is not publicly available.

Non-public personal information, for example, would include any information a consumer provides the financial institution on a 1003 mortgage loan application, information from a consumer credit report obtained by the financial institution in connection with the loan application, any account information such as the balance, payment history, or servicing records, or even any information indicating that the individual is or has been the financial institution's customer. But the term does not include blind data that does not identify a consumer or contain personal identifiers, such as account numbers, names, or addresses.

Furthermore, the financial institution is not limited in making disclosures of *publicly available information*, which would include any information that a financial institution has a reasonable basis to believe is lawfully made available to the general public, including government records (such as real estate recordings and security interest filings) and widely distributed media (such as telephone books, newspapers, or Web sites available to the general public on an unrestricted basis). But a financial institution would not have a reasonable basis to believe a consumer's telephone number is publicly available information, for example, unless the number is located in the telephone directory or the consumer has informed the financial institution that the number is not unlisted.

Even after complying with the notice and opt out requirements of the Privacy Rules, financial institutions are generally prohibited from disclosing to any non-affiliated third party, other than to a consumer reporting agency, a consumer's account number or similar form of access number or code for credit card, deposit, or transaction accounts for use in telemarketing, direct mail marketing, or e-mail marketing to the consumer. However, a financial institution may disclose an account or other access number to its own agent or service provider to provide marketing for its own products or services (as long as the agent or provider is not authorized to directly initiate charges to the account), or to a participant in a private label credit card program or affinity program where participants to the program have been identified to the consumer when entering into the program. But a financial institution may include such an account or other access or code number in an encrypted form with other financial information that it is permitted to disclose under this general rule if the recipient is not provided the means to decode the number or code.

Permitted Exceptions

Three broad exceptions (the "Permitted Exceptions") are made to the notice and opt out requirements under the Privacy Rules. The opt out requirements do not apply when a financial institution discloses non-public personal information about a consumer to a non-affiliated third party if the disclosure is for any of the following purposes:

- *Service Providers and Joint Marketing.* When made to non-affiliated third parties to perform services for the financial institution or functions on its behalf if the initial privacy notice is given the consumer and the financial institution enters into a contractual agreement with that third party that prohibits the third party from disclosing or using the information for any purpose other than to carry out those services or functions, or for purposes of another of the Permitted Exceptions.
- *Processing and Servicing Transactions*. When made to non-affiliated third parties as necessary to effect, administer, or enforce a transaction that a consumer requests or authorizes, or that is made in connection with (i) processing a financial product or service that a consumer requests or authorizes, (ii) maintaining or servicing the consumer's account with the financial institution (or with another entity as part of a private label credit card program or other extension of credit), or (iii) a proposed or actual securitization or secondary market sale (including sales of servicing rights).
- *Other Permitted Purposes.* When made to non-affiliated third parties for other permitted purposes, such as when disclosures are made to persons holding a legal or beneficial interest in the consumer; when made with the consumer's consent or at the consumer's direction; when made to fiduciaries or other representatives of the consumer; when necessary to protect confidentiality or security of the financial institution's business records or to protect against the potential of fraud or unauthorized transactions; when made to the financial institution's own attorneys, accountants, auditors, or advisory organizations; when made in accordance with the Right to Financial Privacy Act of 1978 to law enforcement agencies, state insurance authorities, self-regulatory agencies and others; when made to a consumer reporting agency in accordance with the Fair Credit Reporting Act; or when made to comply with federal, state or local laws, or to comply with subpoena, summons, or other judicial process.

The Opt Out Right

A consumer has the right after receiving required privacy and opt out notices to direct a financial institution not to disclose non-public personal information about the consumer to a non-affiliated third party, other than as authorized by the Permitted Exceptions.

A financial institution must give the consumer a reasonable opportunity to exercise this opt out right before disclosing the information to any non-affiliated third party. Generally, allowing a consumer 30 days (after the date of mailing of the required notices) in which to opt out by returning a check-off form by mail or calling a toll-free telephone number would satisfy this requirement.

If a single opt out notice is given to joint consumers, as permitted by the Privacy Rules, the notice must explain how the financial institution will treat the opt out direction given by any one of the joint consumers. The financial institution, for example, may treat such an opt out direction as applying to all the associated joint consumers or permit each joint consumer to opt out separately. However, the financial institution in that case must permit any joint consumer to opt out on behalf of all the joint consumers, and may not require that all joint consumers separately opt out before honoring the opt out direction of any one of them.

Although the financial institution may disclose non-public personal information to non-affiliated third parties after satisfying these notice requirements and the passage of a reasonable time under the Privacy Rules, the consumer's right to opt out is a *continuing* right and may be exercised *at any time*. A financial institution

must comply with the consumer's direction to opt out *as soon as reasonably practicable* after receiving it. Once given, the consumer's direction to opt out is effective until the consumer revokes it in writing. Furthermore, when a customer relationship terminates, the former customer's opt out direction continues to apply to information that the financial institution collected during, or related to, that relationship. But if the former customer subsequently establishes a new customer relationship with that same financial institution, the opt out direction that applied to the former relationship does not carry over and apply to the new customer relationship.

Limits on Re-Disclosure and Re-Use

The authority of a financial institution to re-disclose or re-use non-public personal information received from a non-affiliated financial institution is limited under the Privacy Rules whether received under one of the Permitted Exceptions or outside of an exception.

A financial institution receiving the information under one of the Permitted Exceptions may disclose the information to an affiliate of the financial institution from which it received the information or to its own affiliates. But the financial institution and its affiliates in that case may only disclose and use the information in the *ordinary course of business* to carry out the activity covered by the exception under which it received the information.

If receiving the information other than under one of the Permitted Exceptions, the financial institution receiving the information may disclose the information to affiliates of the financial institution from which it received the information and to its own affiliates. But the financial institution and its own affiliates in that case may not disclose the information to any other person unless the disclosure would be lawful if made directly to that person by the financial institution from which it originally received the information. In that case, the financial institution could disclose the information in accordance with the privacy policy of the financial institution from which it received the information (as limited by the opt out direction of any affected consumer) or in accordance with a Permitted Exception.

Notices Required to Consumers and Customers

A financial institution must provide an initial privacy and "opt out" notice to any individual who becomes its customer when the customer relationship is established and a similar privacy notice not less frequently than annually during the continuation of the customer relationship.

The financial institution is not required to give the initial privacy and opt out notices to a consumer with whom it has not established a continuing customer relationship, however, until and unless the financial institution intends to make a disclosure of non-public personal information about the consumer (other than a disclosure authorized by a Permitted Exception) to a non-affiliated third party, in which case the notices must be given before the disclosure to third parties may be made. In any case, the non-public personal information may not be disclosed to non-affiliated third parties if the consumer or customer, after receiving notice, elects to "opt out" within a reasonable period of time.

An important distinction is made for this purpose between a *consumer*, who is a natural person that obtains a financial product or service from the financial institution for primarily a personal, family or household purpose, and a *customer*, who is a consumer that has a continuing customer relationship with the financial institution. A consumer relationship with a mortgage broker or lender is established when an individual applies for a home mortgage loan, regardless of whether the credit is extended, or when the individual provides non-public personal information to obtain a determination of whether he or she may qualify for a home mortgage loan (i.e., a "pre-qualification"). If the individual then enters into an agreement with a

mortgage broker to arrange a home mortgage loan or actually obtains a loan from a mortgage lender, the individual is deemed to have such a continuing relationship and is by definition the customer of the mortgage broker or lender.

But this customer relationship terminates under the Privacy Rules if the home mortgage loan is then sold and the lender does not retain the rights to service the loan. Under this special rule for loans, a customer relationship is established when the loan is originated but, if the lender subsequently transfers the servicing rights to that loan to another financial institution, the customer relationship transfers with the servicing rights. Therefore, any financial institution acquiring servicing rights to a home mortgage loan establishes a new customer relationship under the Privacy Rules. In this case, when establishing the customer relationship is not at the customer's election, the financial institution must provide the customer a new initial privacy notice within a *reasonable time* after acquiring the servicing rights and, thereafter, must provide a privacy notice at least annually during the continuation of the customer relationship. The annual notice may be given in any 12-consecutive month period defined by the financial institution if given on a consistent basis. Note that it is the financial institution owning the servicing rights that has the customer relationship and notice obligations under the Privacy Rules and not, if different, the contract servicer who merely acts as an agent for the financial institution.

Although the sale and transfer of the servicing rights also transfer the customer relationship, it is important to note that the mortgage broker and lender transferring these rights still retains a *consumer* relationship with that same individual and is prohibited subsequently from disclosing non-public personal information about the consumer to non-affiliated third parties without first complying with the initial notice requirements and providing its former customer with an opt out opportunity.

The obligation of a financial institution to provide a customer an annual privacy notice in any case continues until the termination of the customer relationship. No further notices must be given to former customers. In the case of a mortgage broker providing loan brokerage services, the customer relationship terminates when the customer has obtained and closed a loan through the broker or has ceased using the broker's services for that purpose. (Similarly, for other real estate settlement services, the customer relationship terminates at the time the customer executes all documents related to the real estate closing and the settlement service provider has completed all its responsibility regarding the closing and received payment for its services.) When the mortgage lender has retained servicing rights to a home mortgage loan it originates or a financial institution has acquired loan servicing rights, the customer relationship terminates when the customer pays the loan in full, the loan is charged off, or the loan is sold without retaining the servicing rights.

A financial institution also may have an obligation to provide a *revised privacy notice* if, during the continuation of a customer relationship, an existing customer obtains a new financial product or service. The initial privacy notice requirement may be satisfied in this case by either providing a revised privacy notice that accurately reflects current privacy policies and practices with regard to the new financial product or service or, if the initial, revised, or annual notice most recently provided to the customer is still accurate with regard to the new product or service, no new privacy notice must be given. In that case, for example, an existing customer's application for a home equity loan, in addition to her first-mortgage home loan serviced by the same financial institution, may not require a revised disclosure, but if the first-mortgage loan is refinanced in the new loan transaction (thereby discharging the debt and terminating that customer relationship), it appears that a new initial privacy notice would be required under the Privacy Rules. Even if an existing customer has not obtained a new financial product or service, a financial institution also must provide such a revised privacy notice reflecting its currently accurate policy and practices and a new opportunity to "opt out" if at any time the financial institution, directly or through an affiliate, discloses non-public financial information about a consumer to a non-affiliated third party other than as described in its initial privacy disclosure or its last revised or annual notice to the consumer.

Form and Content of Required Notices

Privacy Notice. Generally, the required privacy notice must provide a clear and conspicuous notice to consumers and customers that accurately reflects the financial institution's privacy policies and practices. The initial, annual, and revised privacy notices required under the Privacy Rules must include each of the following items of information that apply to the financial institution providing the notice or to the consumer receiving the notice:

- The categories of non-public personal information the financial institution *collects* (i.e. obtains in a manner that is organized and can be retrieved by the name of the individual or by an identifying number, symbol, or other identifying particular assigned the individual) and discloses regarding both its customers and former customers; and the categories of affiliates and non-affiliated third parties to whom the disclosures are made (other than Permitted Exceptions);
- If disclosures (other than the Permitted Exceptions) are made by the financial institution to non-affiliated third parties, a separate statement of the categories of information disclosed and the categories of third parties with whom the financial institution has contracted;
- An explanation of the consumer's right to "opt out" of the disclosure to non-affiliated third parties, including the methods by which the consumer may exercise that right at that time;
- Any disclosures that the financial institution makes under applicable provisions of the federal Fair Credit Reporting Act (regarding the consumer's ability to opt out of disclosures of information among affiliates);
- Policies and practices regarding the financial institution's protection of confidentiality and security of non-public personal information; and
- If the financial institution makes disclosures authorized by the Permitted Exceptions, a statement that the financial institution makes disclosures to other non-affiliated third parties "as permitted by law."

Opt Out Notice. The form of "opt out" notice must be clear and conspicuous and accurately explain the right of the consumer to opt out of any disclosure of non-public personal information about the consumer and a reasonable means by which the consumer may exercise the opt out right. Generally, this latter requirement is satisfied if the notice contains a check-off box in a prominent position that the consumer may mark to indicate his election to opt out and use as a reply form (which includes the address to which the form should be mailed) or provides a toll-free telephone number that the consumer may call to opt out. The financial institution may require the consumer to use a *specific* means to opt out if the means is reasonable for the consumer, but may not require a burdensome method to exercise the opt out right, such as requiring the consumer to write his or her own letter. The opt out notice may be provided together with, or on the same written or electronic form as, the initial privacy notice given to the consumer or customer.

Simplified Notice. If the financial institution does not disclose, and does not desire to reserve the right to disclose, non-public personal information about customers or former customers to affiliates or non-affiliated third parties (except as authorized by the Permitted Exceptions), however, the financial institution may provide a simplified notice that states that fact and additionally provides only the following items of information:

- The categories of non-public information the financial institution collects;
- The financial institution's policies and practices regarding protecting the confidentiality and security of non-public personal information;
- If true, a statement that the financial institution makes disclosures of non-public personal information to third parties "as permitted by law."

Short Form Notice. Before disclosing any non-public personal information about a consumer to any non-affiliated third party, a financial institution must satisfy the initial privacy notice requirements at the same time as it delivers an opt out notice. In that circumstance, when no customer relationship had been

established and no initial privacy notice earlier given, the financial institution may satisfy the initial disclosure requirements for a consumer who is not a customer with a short-form initial notice. The short-form notice, instead of describing the financial institution's privacy policies and practices may simply state that its privacy notice is available upon request and explain a reasonable means by which the consumer may obtain the notice, such as providing a toll-free telephone number that the consumer may call to request the notice.

Sample clauses illustrating some of the required notice content are included as Appendix A to the Privacy Rules.

Delivering Privacy and Opt Out Notices

Financial institutions, when required to make initial, annual, and revised privacy and opt out notices to consumers and customers, including short form initial notices, may deliver the notices by either hand delivery of a printed copy of the notice, mailing of a printed copy of the notice to the last known address, or by other means by which the consumer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, electronically. Orally explaining the notice, either in person or over the telephone, does not satisfy the notice requirements for either consumers or customers, and any notice provided a customer must be in a form that the customer can retain or obtain later in writing or, if the customer agrees, electronically.

A financial institution may provide a joint notice from it and one, or more, of its affiliates or other financial institutions identified in the notice as long as the notice is accurate with respect to all the financial institutions. Furthermore, if two or more consumers jointly obtain a financial product or service from the financial institution, the initial, annual, and revised privacy notice requirements may be satisfied by delivering the notice or notices to those consumers jointly, unless one or more of those consumers request separate notices.

Although a financial institution may disclose non-public personal information about a consumer to non-affiliated third parties after satisfying these notice requirements and the passage of a reasonable time under the Privacy Rules, the consumer's right to opt out is a *continuing right* and may be exercised at any time. A financial institution must comply with the consumer's direction to opt out *as soon as reasonably practicable* after receiving it.

Conclusion – Most Mortgage Lenders and Brokers Will Have Only Limited Compliance Obligations

The new Privacy Rules are effective November 13, 2000, but mandatory compliance has been extended by rulemaking to July 1, 2001, when all financial institutions covered by the G-L-B Act must have provided the initial disclosures to all consumers who are their customers as of that date and must have implemented policies and procedures to assure compliance with the new privacy rules after that date.

Most mortgage lenders and mortgage brokers would appear to have only limited compliance obligations under the G-L-B Act and the Privacy Rules, however, because of the short duration of their customer relationships with consumers for whom they originate loans and perform other financial services. While a customer relationship is established with the mortgage lender when closing a home loan, the customer relationship then terminates when the mortgage lender sells and assigns the loan to an investor without retaining the servicing rights. In the case of a mortgage broker, a customer relationship is established when a loan applicant enters into an agreement with the mortgage broker to arrange or broker a home loan, but the customer relationship then terminates when the loan has closed and the broker has performed all of its responsibilities in regard to the loan transaction and has been paid for its services (or earlier if the applicant ceases using the services of the broker for that purpose). Therefore, most mortgage brokers and mortgage lenders will have

no obligation to make annual or revised privacy notices because their customer relationships terminate upon loan settlement or the subsequent sale and transfer of the home loan with servicing rights released, and these ongoing notice obligations then become the responsibility of the transferee noteholder and its servicing agent under a newly established customer relationship. Although both the mortgage lender and mortgage broker must give an initial privacy notice to consumers when the customer relationship is established, they may use a *simplified* form of privacy notice when they do not disclose, and do not desire to reserve the right to disclose, non-public personal information about their customers or former customers as a matter of policy. Once the customer relationship terminates, however, the mortgage lender and mortgage broker still retain a consumer relationship with their former customers and continue to be restricted under the Privacy Rules regarding their ability to disclose non-public personal information about the consumer that was collected by them in connection with the loan or other financial service.