# Proposed Report

# Proposed Report of the Joint Legislative Committee to Review the State's Regulatory Oversight Over Financial Resources Mortgage, Inc.

## August 31, 2010

**Proposed Report for Committee Discussion**
**August 31, 2010**
**Subject to Change**

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## I. Charge of the Joint Committee

On April 19, 2010, the Speaker of the House and the President of the Senate requested that the House and Senate Commerce Committees conduct joint hearings regarding the State's regulatory oversight over Financial Resource Mortgage, Inc. ("FRM") and similar companies. In order to fulfill the Legislature's independent role of investigating the functioning of state government, the Senate President and Speaker charged the joint committee with:

- Reviewing in detail the ways in which our state regulatory system functioned and failed to function to protect investors regarding their FRM investments;

- Examining the jurisdiction and scope of regulatory oversight and investor protection provided by the Department of Banking, the Bureau of Securities in the Secretary of State's Office, and the Consumer Protection Bureau in the Department of Justice;

- Determining whether current regulatory structures created obstacles to cooperation among the entities that had jurisdiction over FRM's activities;

- Making recommendations to modernize and strengthen the state's regulatory structures to better protect investors in the future; and

- Recommending a timeframe for adopting any needed reforms.

## II. Joint Committee Membership

### Senate Commerce, Labor and Consumer Protection Committee

Senator Margaret Wood Hassan, Chair
Senator Betsi L. DeVries, Vice Chair
Senator Deborah R. Reynolds
Senator Jacalyn L. Cilley
Senator Peter E. Bragdon
Senator Sheila Roberge

**House Commerce and Consumer Affairs Committee**

Representative Edward Butler, Chair
Representative Donna Schlachman, Vice Chair
Representative James Headd, Clerk
Representative Stephen DeStefano
Representative Paul McEachern (Rep. McEachern recused himself from participating in the Joint Committee)
Representative Joel Winters
Representative Angeline Kopka
Representative David Meader
Representative Jill Shaffer Hammond
Representative Susi Nord
Representative Sandra Keans
Representative Kenneth Gidge
Representative John Hunt
Representative Matt Quandt
Representative Ronald Belanger
Representative Donald Flanders
Representative Rip Holden
Representative Patricia Dowling
Representative Chris Nevins
Representative David Palfrey

## III. Background and Chronology

According to the Report of the Attorney General:

> FRM operated a residential and commercial mortgage brokerage and lending business in Meredith, New Hampshire…. FRM was owned by Scott D. Farah. C L and M, Inc. ("CLM") purported to be a commercial loan servicer owned by Donald E. Dodge. Both businesses closed their doors in November 2009. …Since at least 2005, FRM and CLM are alleged to have operated a Ponzi scheme that defrauded at least $20 million from at least 150 investors. The operation and subsequent closure of FRM and CLM have

had a substantial and long lasting impact on the investors who, in many cases, lost their life savings.[1]

In early February, 2010, legislative leaders contacted Attorney General Michael Delaney advising him of the Legislature's deep concern regarding reported events involving Financial Resources Mortgage, Inc. ("FRM") and its principal, Scott Farah. In light of the devastating financial consequences to a large number of constituents, legislative leadership reluctantly expressed the House and Senate's willingness to defer a legislative inquiry into the matter pending completion of an investigation undertaken by the Attorney General's Office.

On February 19, 2010, Attorney General Delaney briefed Senator Margaret Hassan and Representative Edward Butler, the respective Chairs of the Senate and House Commerce Committees, on the background of issues pertaining to FRM. The Attorney General advised that his office had become involved after FRM shut its doors in November 2009. The Banking Department subsequently took action to place the company into bankruptcy. The Attorney General noted that the matter was complicated by the fact that the Banking Department and the Bureau of Securities Regulation ("the Bureau" or "BSR") arguably had concurrent jurisdiction over aspects of FRM's business dealings. Conflicts had arisen in the communications between the agencies and there was an ongoing dispute about BSR's access to certain records maintained by the Banking Department.

As of February 19, 2010, a number of civil lawsuits had been filed and attachments had been placed on property held by individuals and various business entities, including FRM. On the criminal side, the Attorney General's Office had invited the Federal Bureau of Investigation and the United States Attorney's Office for the District of New Hampshire to commence an investigation of the company and its principals. Following that investigation, on April 7, 2010, criminal indictments were returned against Scott Farah and FRM co-owner Donald Dodge for violations of federal law, including mail fraud and wire fraud. On April 9, 2010, the Securities and Exchange Commission filed a Complaint against Scott Farah, Donald Dodge, FRM and CL and M, Inc. (a related mortgage servicing company) alleging that from 2005 forward, the defendants operated a Ponzi scheme that defrauded at least 150 citizens out of at least $20,000,000.

During the months of March and April 2010, at the request of the Governor and Executive Council, and in its capacity as general supervisor pursuant to RSA 7:8 , the

[1] Attorney General Report at p. 2, May 12, 2010. For a more full account of FRM's alleged activities see the Attorney General's Report as well as the SEC complaint against Scott Farah.

Attorney General's Office ("the Office" or "AGO") completed a review of the operation of the three agencies that had oversight responsibility in connection with the activities undertaken by FRM. The Bureau of Securities Regulation of the Secretary of State's Office had jurisdiction over enforcement of the State's securities laws and was the first State agency to receive a complaint regarding FRM. The Banking Department had jurisdiction over FRM's activities as a licensed mortgage broker and mortgage banker. The AGO had jurisdiction over unfair and deceptive business practices that did not fall within the exclusive jurisdiction of the Banking Department or BSR. The Office also had contact with FRM-related matters in its capacity as legal counselor to BSR. In addition, the Attorney General's Office had authority in its capacity as the chief law enforcement agency in the State to pursue criminal violations committed by FRM and CL & M, Inc. in connection with fraudulent business dealings and/or fraudulent securities offerings.

On April 19, 2010, Senate President Sylvia Larsen and Speaker of the House Terie Norelli charged the House and Senate Commerce Committees with conducting joint hearings on the FRM matter in order to allow the Legislature to fulfill its independent role in investigating the functioning of State government.

On May 7, 2010, the Joint Commerce Committee held an organizational meeting and heard presentations from House and Senate Legal Counsel on the statutory and regulatory framework within which FRM had operated.

The Attorney General's Office released its report on FRM on May 12, 2010 and presented it to the Governor and Executive Council on the same date. The report provided detailed findings regarding the substantial contacts that the Banking Department and BSR had with FRM and the opportunities that arose over a span of eight (8) years for Banking, BSR or the Attorney General's Office to have taken action to stop FRM's continuing and escalating violations of various State laws.

Subsequently, the Joint Commerce Committee held hearings on May 14th, May 21st, May 28th, June 14th, June 17th and June 21st. The Committee heard testimony from:

Mark Connolly, Director of the Bureau of Securities Regulation, Office of Secretary of State,

Jeffrey Spill, Hearings Examiner, Bureau of Securities Regulation, Office of Secretary of State

Professor Joseph Long, University of Oklahoma, Expert for the Bureau of Securities Regulation and Acting Director of the Bureau of Securities Regulation, Office of Secretary of State,

Peter Hildreth, Commissioner Department of Banking,

Mary Jurta, Director of Consumer Credit Division, Banking Department,

Michael Delaney, Attorney General, Department of Justice

Richard Head, Associate Attorney General, Department of Justice

Kelly Ayotte, Former Attorney General

Peter Heed, Former Attorney General

William Gardner, Secretary of State

Michael Krebs, ESQ., Nutter McClennan & Fish, Boston, MA, Expert Counsel for the Office of Attorney General

Robert Fleury, Deputy Banking Commissioner,

Celia Leonard, ESQ., General Counsel, Banking Department

Susan McIlvene, Kittery Point, Maine, Lender of funds through FRM,

Al McIlvene, Kittery Point, Maine, Lender of funds through FRM,

Ken Miller, Amherst, NH, Lender of funds through FRM,

Joseph Hoffman, Gilford, NH, and

Additional testimony from the public including numerous individuals who lost substantial amounts of money through their dealings with FRM (A recording of the May 28th public testimony is available at: http://gencourt.state.nh.us/joint/).

## IV. Executive Summary of Report

The FRM matter serves as an opportunity to better understand the regulatory structures that are in place in New Hampshire to protect consumers, investors and lenders. The FRM hearings have identified at least four areas of material weakness in the current structures which are appropriate subjects for reform efforts, including the:

1. Management and operational functioning of regulatory entities;
2. Jurisdictional authority of regulatory agencies and the scope of the Consumer Protection Act;
3. Interdepartmental communication and cooperation; and
4. Communication with the public and mechanisms for providing public notice.

This report provides an overview of the statutory authority of the three agencies that had contact with or regulatory oversight over FRM. Highlights of witness testimony are provided in order to provide context for the findings and recommendations contained in this report. With respect to each agency, the testimony is reviewed in order to determine what caused operational delays or failures to occur and how these problems may be avoided in the future. A jurisdictional analysis is provided for each agency in order to explain the foundation for recommendations for legislative solutions.

The testimony provided by agency heads and other witnesses demonstrated a keen recognition of operational failures within the Securities Bureau, the Banking Department and the Attorney General's Office. In some cases, management errors or omissions were also present. The hearings also confirmed significant disagreement among regulators regarding the scope of the Bureau of Securities Regulation's jurisdiction and authority, and identified issues that have arisen regarding the respective jurisdiction and authority of the Banking Department and the Attorney General's Office with respect to consumer protection matters. All of the agencies agreed that work was needed to improve interdepartmental communication and cooperation.

In the course of conducting the hearings and deliberating on the information it received, the committee identified the following as necessary components of an effective regulatory and consumer protection system:

a) A clear definition of the different types of transactions being regulated, and an understanding of which agency is responsible for each type of transaction;
b) The ability to respond in a timely manner and address newly evolving regulatory and consumer protection challenges, as well as complaints from the public;
c) Sharing of information among consumer protection and regulatory agencies about potential bad actors and cooperation between these agencies where they have overlapping authority;
d) Operational/management practices that ensure follow-through on complaints, including timely enforcement action;
e) Sufficient resources to fulfill these responsibilities;
f) An easy-to-use and regularly updated database or similar mechanism that the public can use to access information regarding substantiated violations across all the regulatory agencies in New Hampshire; and
g) A regulatory system that protects the public while not impeding business investment and economic growth in New Hampshire.

The Committee recognizes that there must be a balancing of the protection of the public and the possible negative effect of increased regulatory requirements on business investment and economic growth. Further, implementing a regulatory system capable of identifying bad actors in advance may well involve an increased cost to taxpayers. The challenge for the Legislature will be to enact reforms to ensure that regulators will detect fraudulent business conduct quickly, and will have the authority, the tools, the mandate, and the resources to limit exposure of the public to such behavior. Further, it is critical to achieve these results in a manner that does not unduly burden the law abiding and fair-minded businesses that are the backbone of the New Hampshire economy.

This report makes a series of recommendations regarding legislative action to better protect the citizens of New Hampshire from this type of behavior in the future. If passed by the Legislature, the Committee believes the recommendations would make it possible for the state to meet the following goals:

1) Reform and clarify the responsibility and jurisdictional authority between and among the Office of the Attorney General, the Bureau of Securities, and the Department of Banking for consumer protection and regulatory enforcement,

2) Ensure that critical information is shared between the various agencies charged with consumer protection,

3) Provide needed flexibility to allow the state to protect the public and respond to the presence of increasingly complex financial instruments,

4) Identify which is the lead agency ultimately responsible for consumer protection in specific circumstances,

5) Provide citizens with a private right of action in the event that regulators fail to adequately respond to consumer protection complaints while protecting legitimate business from frivolous lawsuits, and

6) Require the creation of a centralized database so that the public can access needed information regarding substantiated consumer complaints and regulatory enforcement actions.

The report also makes a series of findings and recommendations regarding the operational and management failures in each of the three state agencies in their handling of the FRM matter. **It is imperative that these failures be rectified to protect the**

**public in the future; toward that end, the Joint Committee believes it would be appropriate for the Legislature to require regular reporting to the House and Senate Commerce Committees by the Banking Department, the Securities Bureau and the Department of Justice to ensure that these agencies are meeting their obligations to New Hampshire consumers in a timely and complete way. This Committee also supports the proposed review of agency management contemplated by the inclusion in the FY '11 budget of funding for management consultants for that purpose**.

## V. Purpose of Report

The Joint Committee was convened in order for the legislature to serve its critical function of reviewing the state's regulatory response and administrative capacity with regard to certain consumer protection issues. The purpose of this report is to summarize the information received by the Joint Committee and reflect the Committee's resulting discussions and deliberations. These deliberations led to proposed findings and recommendations intended to prevent future harm to New Hampshire's consumers, investors and lenders. This report is an independent review of the government/regulatory response to the FRM matter, and is not a substitute – nor can it be—for the ongoing civil and criminal investigations of the wide range of illegal and/or deceptive activities that devastated over one hundred lenders, investors and consumers.

With the benefit of hindsight, the FRM matter brought to light numerous regulatory shortcomings that the State needs to address. However, it is important to keep in mind that the FRM matter involved an extensive pattern of alleged fraud, intentional misrepresentation, and deceit on the part of its perpetrators. The Joint Committee recognizes that even the most robust regulatory framework and consumer protection statute may not be able to stop a person who is committed to engaging in intentional criminal behavior. Even when regulatory prevention fails, criminal behavior must be subject to severe societal penalties after the fact.

## VI. Department of Banking

### A. Overview of New Hampshire Banking Laws

The Bank Commissioner has general supervisory authority over all banks, not including national banks, trust companies, building and loan associations, credit unions,

Morris plan banks, small loan companies and other similar institutions in the state.[2] The Commissioner is required to examine the condition and management of these companies every eighteen (18) months, or more often if needed, unless they qualify as highly rated institutions as defined in RSA 383:9-d.

The laws provide that, in addition to the Commissioner's other responsibilities, he or she is to maintain the confidentiality of all records of investigations and reports of examinations that are conducted by the Banking Department. The records are not subject to subpoena and are not to be made public, unless in the commissioner's judgment, "the ends of justice and the public advantage" will be served. RSA 383:19-b.[3]

Pursuant to RSA 383:10-d, Consumer Complaints and Restitution, the Commissioner "shall have exclusive authority and jurisdiction to investigate conduct that is or may be an unfair or deceptive practice under RSA 358-A and exempt under RSA 358-A:3, I." The Commissioner is vested with the authority to hold hearings and to order restitution for persons who are injured by conduct that is found to be unfair and deceptive. In connection with such matters, the commissioner *may* request the assistance and services of the Attorney General's Consumer Protection and Anti-Trust Bureau. And in cases of conduct "involving an alleged criminal offense, the commissioner shall refer to the department of justice all aspects relevant to the criminal investigation and prosecution of such matter." RSA 383:10-d.

RSA 397-A:3 requires persons who engage in the business of making or brokering of mortgage loans secured by real property located in the State to obtain a license from the Banking Department. Under the current regulatory structure, the Banking Department licenses persons "who engage in the business of offering, originating, making, funding or brokering 'mortgage loans' from the State of New Hampshire or mortgage loans secured by real property in the State of New Hampshire."[4] With the enactment of changes required by the federal S.A.F.E. Act, the Banking Department's jurisdiction expanded from oversight of loans on occupied residential property to include loans for the construction of dwellings.

In addition to the license requirements for mortgage brokers, it is unlawful for any individual to transact business in the state as a mortgage loan *originator* with respect to

[2] RSA 383:9
[3] In 2003, the mortgage statute was amended to provide for absolute protection and confidentiality of examination reports, including the comments and recommendations of the examiner. Attorney General Report at p. 30.
[4] Attorney General Report at p. 28.

any dwelling unless he or she is licensed.[5] Originators are now also required to register with a Nationwide Mortgage Licensing System and Registry.[6]

There are additional changes that were made as a result of the S.A.F.E. Act, including a narrowing of the exemptions from the licensing requirements for mortgage brokers. Ironically, one of those changes, effective in 2009, would appear to require the lender/investor victims of FRM to be licensed if they are offering or negotiating terms of residential mortgage loans unless the transactions fall within a narrow exemption offered to individuals in connection with the sale of their own residence or with or on behalf of an immediate family member.[7]

B. Actions and Testimony of the Banking Department

1. Structure of the Regulatory Scheme

During his May 14, 2010 testimony, Banking Commissioner Peter Hildreth touched on the fact that the Banking Department is divided into two Divisions: Banking and Consumer Credit. The Banking Division conducts examinations of banks, which he described as a "very involved multi-week, multi-examiner process."[8] In conducting bank examinations, often in conjunction with the FDIC or other federal regulators, the Division looks at the "safety and soundness of the institution." This includes a review of "CAMELS," or capital adequacy, asset quality, management quality, earnings, liquidity and sensitivity to market risk.

In contrast, Commissioner Hildreth noted that examinations conducted of mortgage banker and brokerage companies are more limited:

> [O]n the consumer credit side it is a much narrower review. We're not out to protect the entity, the mortgage company in this case, make sure it doesn't fail. That's not our role. Our role is to make sure that the

[5] See RSA 397-A:3, II.

[6] The requirement with respect to originators of loans is a new requirement that was implemented in accordance with the requirements of the federal S.A.F.E. Act. The S.A.F.E. Act is a component of HERA (the Housing and Economic Recovery Act of 2008) and is designed to enhance consumer protection and to reduce fraud by encouraging states to establish minimum standards for the licensing and registration of mortgage originators.

[7] May 21, 2010 Transcript at p. 79. Mary Jurta testified on June 21, 2010 that "we license people who lend residential mortgage loan money. So had that ever come to the attention that private money was being used to fund these loans, it would have been an automatic question for the examiners because, okay, well should that entity, person, individual, trust, whatever it might be, it should be licensed."

[8] May 14, 2010 Hrg. Transcript at p. 127-128.

consumer is not harmed. So it's a much different -- so it's a shorter exam and it is a much more focused exam.[9]

2. FRM's Track Record of Examinations and Licensing

From the time of its initial licensing in 1999[10] to the time of its failure in 2009, FRM was examined seven (7) times. The examinations revealed numerous violations, including violations of:

- federal mortgage lending laws,
- inaccurate Truth-in-Lending disclosures,
- inflation of credit report fees,
- failure to report agency investigations and lawsuits,
- lack of a formal procedures manual and internal controls,
- improper record keeping,
- records inadequate to allow the examiner to verify payments to third parties,
- unlawful consumer document disposal practices,
- use of unlicensed trade names,
- ongoing failure to correct past violations, and
- failure to maintain a general ledger or general journal or to conduct business in accordance with accepted norms.[11]

Early examinations also reported the lack of liquidity and insolvency of FRM.[12]

The examinations resulted in referrals for enforcement in 2005 and 2006.[13] Despite the issuance of an Order to Show Cause for License Revocation in December 2005, the process stalled following settlement negotiations and, despite a subsequent referral for enforcement, no hearing was held. According to the Attorney General's Report:

[9] May 14, 2010 Hrg. Transcript at p. 128.
[10] Although there is some inconsistency in the record, FRM had a mortgage bankers' license from the NH Banking Department at least as early as 1999 and possibly earlier. See May 14, 2010 Hrg. Transcript at p. 164. See also Attorney General Report at p. 28.
[11] Detailed information regarding the nature and extent of the violations noted on each visit may be found in the Attorney General's Report at pp.31 – 36. The reports appear at Appendix 5.
[12] Attorney General Report at Exhibit 5; See e.g. May 9, 2001 examination report at p. 3.
[13] Attorney General's Report at pp. 38-39

> On December 16, 2005, the Staff Attorney for the Consumer Credit Division filed a Statement of Allegations. The Statement of Allegations included three counts: failure to implement a program to safeguard consumers' sensitive financial information; failure to have a written safeguard plan; and failure to facilitate an examination. The Statement alleged good cause to revoke FRM's New Hampshire mortgage lending license, and that revocation was in the public interest as FRM "and Mr. Farah have illustrated a willingness to forgo the laws and rules of the State of New Hampshire whenever they see fit. [14]

Even though the Staff Attorney for the Department of Banking found that good cause existed to revoke FRM's license, the Department never held a hearing on the matter and never reached a settlement with the company. The Department closed the matter in 2007 with no finding. Records indicate that a new staff attorney closed the case in February of 2007 with the following file notation: "Delay for unknown reasons. In the meantime nex[t] exam went down and they had essentially fixed all outstanding issues. Closing case without further action."[15.]

It was only after FRM shut down in 2009 that the Banking Department finally revoked its license.

Following the discussion of the scope of examinations performed on mortgage companies, Representative Schlachman inquired, "at what point do you, in fact, revoke a license?"[16] Commissioner Hildreth responded, "I don't have an answer for you."[17] He noted that (as of May 14, 2010) Banking has different procedures, and if an action is taken against an entity, it now appears on Banking's website. He also noted that since the time period in question, Banking has added staff, including paralegals and attorneys.[18]

Several times during the Bank Commissioner's appearance before the Committee, members of the Committee inquired about whether action by the Banking Department to revoke FRM's mortgage broker license could have avoided the outcome or severity of the outcome of the FRM matter. Commissioner Hildreth consistently responded that any action by Banking to revoke FRM's license would not have changed the outcome.[19] "If we had taken his license, it would not have impacted raising money to fund commercial loans. And I say that, I can't imagine how it would have had any impact."[20] On the other

[14] Attorney General's Report at p 3.
[15] Attorney General's Report at pp. 39.
[16] May 14, 2010 Hrg. Transcript at p. 129.
[17] Id.
[18] Id.
[19] May 14, 2010 Hrg. Transcript at p. 189.
[20] May 14, 2010 Hrg. Transcript at p. 121.

hand, he offered that "if Securities had shut them down, I don't know if it would have put them into bankruptcy, that certainly would have put them out of business in whatever year that was."[21]

In follow up testimony on June 21, 2010, Mary Jurta, the Department's Director of Consumer Credit, was asked by Representative Butler why there was not "a sense of accumulation in terms of concern" about the examinations. She noted that there were a number of findings that were "technical in nature . . . [e]very now and then there would be a significant finding."[22] She went on to detail the types of violations, stating in partial conclusion that, "this company was not stellar by any means at all. But do you put it out of business doing residential mortgage loans for those types of infractions? I am used to these kinds of reports. The public, unfortunately, is not."[23]

Notwithstanding the mix of more and less severe problems in the examination reports, the Director of the Consumer Credit Division within Banking acknowledged that in 2006, after withdrawing from negotiations and intending to proceed with revocation, "[we] fell on our face, if you will. And that was due to a lot of internal things that were going on, including the fact that the whole world was blowing up by 2006, 2007, as far as mortgages went."

3. Financial Record Keeping by FRM

Also on June 21, 2010, Senator Hassan questioned Ms. Jurta about FRM's lack of financial recordkeeping:

> I'm looking at the 2006 examination report on Page 6 of it and midway down there . . . it says received documents 6/1 and 6/2/06 to verify the internally prepared December 31, 2005 Statement of Condition. There were numerous errors and adjustments required. Then in italics it says, *Licensee does not maintain a General Ledger and financial records . . .*
> . . .
> [T]he fact that an entity transacting large amounts of money for borrowers and lenders doesn't keep a General Ledger and financial records just struck me as kind of incredible . . . if there's something you see as

[21] May 14, 2010 Hrg. Transcript at p. 189.
[22] June 21, 2010 Hrg. Transcript at p. 78.
[23] June 21, 1010 Hrg. Transcript at p. 81. The Committee is concerned that there may be a disconnect between what the public assumes about regulated entities in the state and what regulators actually see in their reviews and accept as typical. As the Chair of the Joint Committee, Senator Hassan, stated, "[B]y the time I finished,[reading the examination reports] I found myself thinking, you know, I wouldn't buy a pack of gum from these guys." May 14, 2010 Hrg. Transcript at p. 142.

> regulators under our current system that just looks like really bad business practice, whether it's specific violation of one of your rules or not, is there any way for you to address that?[24]

Ms. Jurta responded that the company did have an audit in 2005, 2006 which came in later. She explained that the millions in dollars of transactions were not on the books and records of FRM.[25] She amplified her response, stating that:

> As far as FRM's books and records, they really were quite straightforward. As far as shoebox licensees, if you will, actually we have a fair amount of them, for better or worse. We are in New Hampshire with a ton of small businesses . . . . [W]hether they're doing mortgages, how many people opened up little mortgage brokers – brokerages out of their houses? . . . Many times what we are looking at when we look at them is a bank statement, a bank statement and a checking account. If you think about it, many small businesses do business that way. This company it turns out to be doing really big business and taking big money in, but it was not within our sight.[26]

4. Commissioner Hildreth's Recusal

As revealed in the Attorney General's Report, Commissioner Hildreth confirmed that he learned early on that his brother was an investor in FRM and, accordingly, he had recused himself from the matter on that basis.[27] He added that he wasn't sure whether it was required, but did so because New Hampshire is a small state.[28] He noted that his mistake was not to have put the recusal in writing.[29] The Commissioner acknowledged that, following his recusal, he engaged in certain actions that were inconsistent with that status. He signed a subpoena in the case. He received memoranda regarding the case from a staff attorney and also gave the staff attorney direction to send a copy of an FRM Order to the Concord Monitor.[30] He also took part in a decision in 2006 to invite Securities Regulation to conduct a joint examination of FRM.

When he learned that FRM had closed, Commissioner Hildreth stated that he called his brother to ask if he was still invested with the company. His brother indicated

[24] June 21, 2010 Hrg. Transcript at p. 91.
[25] June 21, 2010 Hrg. Transcript at p. 92.
[26] June 21, 2010 Hrg. Transcript at p. 93
[27] Attorney General Report at p. 39.
[28] May 14, 2010 Transcript at p. 118.
[29] May 14, 2010 Transcript at p. 118.
[30] May 14, 2010 Transcript at p. 119; See also Attorney General Report at pp. 39 – 40.

that he hadn't had an investment with FRM for years.[31] Representative Winters inquired whether, given the many concerns expressed by examiners regarding the company, it might have been appropriate for the Commissioner to check periodically to see if he still had a conflict.[32] The Commissioner responded, "I'll do a personal favor to you that if it ever happens again, every six months or so I'll check with them. How's that?"[33]

In response to overall questions about the Banking Department's lack of follow through on enforcement referrals and the Show Cause Order, Commissioner Hildreth stated that after he learned he no longer had a conflict, he looked at the FRM files. He spoke to the examiners who had been there. He also made a site visit a week after the company closed. He commented that, "[i]n reviewing that file, I can tell you I was not happy that we had not brought that case to a conclusion. It is our biggest failure and I make no excuses for it. It should have gone to a conclusion rather than sort of just end."[34]

5. Interagency Cooperation and Communication

During his testimony, Commissioner Hildreth denied that the current regulatory structure created obstacles to cooperation.[35] He indicated that he had good working relationships with Secretary Gardner and Director Connelly and had cooperated with them in the past. However, Staff of the Securities Bureau testified that in 2003, when they requested Banking's examination reports of FRM, The Banking Department refused to share them, claiming that they were confidential. [36]

Commissioner Hildreth stated that the Banking Department had benefited greatly from having a dedicated attorney from the Attorney General's Office to work on prosecuting Banking enforcement cases.[37] He thought that this would be extremely helpful to the Securities Bureau as well. Both the Commissioner and Ms. Jurta substantially attributed Banking's lack of follow through on FRM enforcement referrals to change in personnel and lack of legal staff.[38]

6. Limits of the Banking Department's Jurisdiction and Authority

[31] May 14, 2010 Transcript at p. 125-126.
[32] May 14, 2010 Transcript at p. 154.
[33] Id.
[34] May 14, 2010 Transcript at p. 121.
[35] May 14, 2010 Transcript at p. 122.
[36] May 14, 2010 Transcript at p. 25.
[37] May 14, 2010 Transcript at p. 123.
[38] May 14, 2010 Transcript at p.128; p. 182-183.

Representative Butler inquired as to the scope of the Banking Department's jurisdiction over FRM. The Commissioner responded that the activities that fell under the purview of Banking were first and second residential mortgages. [39] He noted that the commercial loans made or brokered by FRM did not fall within the jurisdiction of Banking. Upon further inquiry by Representative Butler, Commissioner Hildreth noted that, "[t]he commercial mortgage itself, as far as I know, is really pretty much unregulated." However, he went on to say that when he went to Meredith, he observed documentation of a certain type of transaction, i.e. a commercial loan and a mortgage to go with it, and the mortgage would be held by a trust and percentages of that trust would be sold to investors. In Commissioner Hildreth's opinion, "selling [a] fractional interest in a trust seems to me pretty clearly to be a security and if it's not a security under state law, then I would suggest we ought to change state law so that it is, clearly, is covered."[40]

During the May 14, 2010 hearing, Senator Cilley mentioned that she had recently read Paul Krugman's book entitled "Depression, Economics, and the Crisis of 2008."[41] In the book, Mr. Krugman observed that the current national financial meltdown is due in part to entities that are neither fish or fowl, and which don't easily fit into the framework of either a bank or a security, or securities division or securities company. She asked Commissioner Hildreth to identify areas where it would be helpful to more clearly define what is and what it isn't a security. Using his review of documents in Meredith following FRM's shut down as an illustration, he responded as follows:

> I think it's pretty clear to us what a loan is. Whether it's a mortgage loan, whether it's a car loan, a small loan, it's pretty easy. Securities, there is a [sic] case law and there are some gray areas, I suppose. But I have to tell you when I saw -- when I went up there, and I saw a document that said, well, here's this offering. We have -- they need 400,000, 200,000 has been -- was off the table, which I assume that somebody else had committed to it. And there was, you know, 200,000 on the table and a minimum investment was 50,000. That sounded to me like a security. And when I saw that it was a trust that was divided up and I saw the payout from, you know, 16 percent each month to this person, and 15 percent to this one and 20 percent to that one, it -- it sort of looked like a security to me. And I'm sure there are instruments from my reading, and I haven't read that book or many others on that level of depth about the recent issues. I haven't had a lot of time. But I know that there are, you know, there are instruments that

[39] May 14, 2010 Transcript at p. 138.
[40] May 14, 2010 Transcript at p. 139.
[41] May 14, 2010 Transcript at p. 137.

the people selling them and the people buying them evidently had no idea, really understood what they were. So I'm sure they're out there.[42]

7. Confidentiality of Bank and Mortgage Broker Records

During the course of the hearing, Commissioner Hildreth also addressed the issue of the confidentiality of bank records and examinations. He testified that the confidentiality provision was structured as it was primarily for banks to protect depositors, and basically to prevent a run on the banks. He observed that the consumer credit side was covered by the strict confidentiality provisions as well, by extension.[43]

Commissioner Hildreth agreed that it was important to have information sharing among agencies. In fact, Mary Jurta noted that while there was a time when they were not able to share certain information, Banking had changed the law that it could share information with other agencies. [44] Despite the change in the law, the Commissioner acknowledged that the issue of confidentiality is a very sensitive subject for banks, credit unions and other entities as well. As a regulator, Banking relies on the institutions and entities it regulates to be truthful about their financial condition. It receives and maintains confidential commercial information that could hurt regulated entities. Thus, whether to release information becomes a balancing test in each case.[45]

C. Management and Operational Functioning of the Banking Department

**Finding 1: The Banking Department Was Ineffective in the Use of its Examination Authority**

By law, the Banking Department was required to examine the condition and management of FRM, a licensed mortgage banker and mortgage broker, every 18 months.[46] Banking did so, and, after intervention by the Attorney General's Office, examination reports for the years 2001, 2003, 2004, 2006, 2007, 2008 and 2009 have been made public. The reports reveal a number of areas of non-compliance, leading to two referrals for enforcement within the Department. Among other things, the

[42] May 14, 2010 Transcript at p. 137-138.
[43] May 14, 2010 Transcript at p. 141. Based on information provided in the Attorney General's Report, HB 817, enacted in 2003, "added language to the examination section of the mortgage statute including a provision for the confidentiality of examination reports." Commissioner Hildreth appeared to indicate in his testimony that when mortgage companies were added to the Banking Department's jurisdiction, the banking confidentiality provisions simply extended over to consumer credit.
[44] May 14, 2010 Transcript at p. 133.
[45] May 14, 2010 Transcript at p. 179.
[46] RSA 383:9

examinations pointed to the poor financial condition of FRM. Based on the testimony from Banking, it is unclear how the examination reports for mortgage companies are used from an operational standpoint.

Commissioner Hildreth described the examinations which occurred in the consumer credit context as encompassing a much narrower review than bank examinations. He indicated that Banking's role is not to ensure that the company doesn't fail, but to ensure that the consumer is not harmed. If nothing else, the FRM matter illustrates that when a company fails, whether it is a bank or a mortgage brokerage concern, there is potential for harm to consumers and to other business people. Here, the harm resulted in large part from FRM's failure to run its business in a straightforward enough manner to be capable of being fully examined. Despite that, during Banking's very first examination of FRM, the examiner reported that "audited financial statements for 1999 and 2000 indicate that the company has no liquidity and is insolvent.[47]

In 1999 or 2000, insolvency may not have been adequate reason on its own to revoke a mortgage brokerage license. But it is important to note that RSA 397-A was amended in 2009 to provide that:

> An applicant or licensee shall demonstrate and maintain a positive net worth and an amount of positive net worth shall be set by rule. Minimum net worth shall be maintained in an amount that reflects the dollar amount of loans originated as determined by the commissioner.

Moreover, RSA 397-A-5 was amended in 2009 to amplify existing requirements for applicants to submit "detailed financial information sufficient to determine the applicant's ability to conduct the business of a mortgage broker with financial integrity," including a new requirement that the application include a "statement of net worth prepared in accordance with generally accepted accounting principles." It seems clear that the financial health of a company authorized by the State to engage in substantial financial transactions is and should be relevant to its ability to maintain a license. It also appears clear that as the financial industry and financial instruments have evolved, the nature of lenders, investors and consumers have evolved as well.

During the hearings, there was testimony that FRM operated as a "shoebox licensee" and that this was not unusual in New Hampshire. Yet, the examination reports reflect that millions of dollars of loans were being handled by the company.[48] Following the hearings, it remains unclear what could and couldn't be determined by the agencies

[47] Attorney General Report at p. 31.
[48] Attorney General report at p. 32.

about FRM's financial status and business activities based on records reviewed both by Securities and Banking. Based on the content of the examination reports themselves, there appears to have been ample reason for concern about the business conduct of FRM from the inception of its status as a licensed company.

### Finding 2: Banking Failed to Recognize the Significance of Multiple Consumer Complaints

In addition to the many examinations that gave notice of trouble in the company, the Department also received fifteen complaints over a ten (10) year period between 1999 and 2009 relating to FRM.[49] One of the complaints, received in 2004, was submitted by a former employee of FRM and was more in the nature of a whistleblower complaint than a consumer complaint.[50] The former employee alleged improper loan practices and improper disposal of confidential consumer information. She asserted that the company churned files and that she could no longer work there and be forced to tell lies. The information furnished in the complaint was used in the next examination and the auditor confirmed that the company was indeed failing to shred documents that contained sensitive information such as social security numbers. FRM's 2004 examination resulted in a referral for enforcement. Despite that, no action was ultimately taken by Banking.

Of the fifteen (15) complaints received by banking between 1999 and 2009, five were either not resolved or Banking found that it lacked jurisdiction. With respect to those cases in which there was a finding of no jurisdiction, it appears that reporting back to the Attorney General's office or some other regulatory entity may have been warranted.

### Finding 3: Banking Failed To Follow Through On Enforcement

On December 16, 2005, a staff attorney for the Banking Department filed a Statement of Allegations with respect to FRM. On December 20, 2005, the Department issued an Order to Show Cause for License Revocation based on the statement of allegations.[51] A scheduled hearing was postponed pending settlement negotiations between a Banking Department staff attorney and an attorney representing FRM.[52] As of May 24, 2006, Banking was ready to pursue license revocation. A follow up examination occurred in 2006 after the Concord Monitor published an article on Scott Farah and the

[49] Attorney General Report at p. 36. The number of complaints gave rise to a negative comment in one of the examinations.
[50] Attorney General Report at p. 49. See Appendix to Banking Department Report – Consumer Complaint dated 9/7/2004.
[51] Attorney General's Report at p. 38
[52] Id.

Center Harbor Christian Church.[53] This examination resulted in a second referral for enforcement. However, no further action was taken and the matter was closed by a new staff attorney in February of 2007 based on agency delay and perceived improvements in some areas of deficiency.

While some improvement was noted in the 2007 report, FRM's 2008 and 2009 examinations revealed numerous ongoing problems. Significantly, the 2008 examination revealed that FRM was again working with unlicensed entities, including unlicensed mortgage servicer CL & M,[54] with which it shared a building. When the issue was discovered, FRM was apparently allowed to transfer the loans to itself, and Banking took no action to look into the activities of the unlicensed CL & M. It also failed to pursue any action against FRM for the continuing violations.

It was unclear why Banking did not attempt to examine CL&M when it learned that it was acting as a loan servicer for FRM. Had Banking followed through in this area it may well have found the money trail.

### Finding 4: Banking Failed to Acknowledge the Potential Impact of its Regulatory Failure

As acknowledged by Commissioner Hildreth and Ms. Jurta, Banking "fell on its face" in terms of its enforcement efforts with respect to FRM. No other agency had as much information at its disposal, and yet, Banking did not follow through on two separate enforcement referrals. Despite the damage that later resulted from FRM continuing to do business, whether as a mortgage broker or issuer of securities, Banking did not agree that its failure to revoke FRM's license was a factor in the harm that later occurred. Like the Securities Bureau, which focused narrowly on its attempts to resolve a specific set of violations, Banking focused narrowly on the limits of its jurisdictional authority with respect to the brokerage of loans involving residential real estate.

Commissioner Hildreth testified that revoking FRM's license would not have stopped it from engaging in brokerage activities with respect to commercial real estate loans. While this may be true, the action of revoking the license may have helped alert those in the lending community of a problem. Due to its focus on residential borrowers as a constituency, Banking lacked an appreciation of the way in which the protections afforded by licensing might have been used and relied upon by other lenders and investors.

[53] Attorney General's Report at p. 39
[54] Attorney General Report at Appendix 5.

### Finding 5: The Commissioner Failed Adequately to Alert Staff and Maintain his Recusal

Commissioner Hildreth's failure to maintain recusal was also an operational failure. Moreover, there was no indication during the hearings that he made concerted, systematic efforts to notify staff of the conflict or made clear efforts to reassign his oversight responsibilities with respect to FRM, either as Director of Securities Regulation or as Banking Commissioner, after becoming aware of it.[55] As a result, there was no one person responsible to ensure that the enforcement referrals were carried out, or that a hearing was held on the Show Cause Order.

The recusal itself was flawed in that it lacked any definition. The Commissioner continued to have contact with the FRM matter, despite the fact that he knew or believed that his brother was an investor in the company.

The Banking Department has since prepared a draft recusal policy to use until the Attorney General's statewide policy is ready. Ironically, as written, it would not have precluded the Commissioner from presiding over a matter in which a family member, such as his brother, had a direct financial interest unless they shared a household.

### Finding 6: The Banking Department Did Not Use its Authority to Share Records with Securities Regulators.

Finally, as more fully discussed in the jurisdiction section of this report, the Banking Department's confidentiality requirements remain a problem. Despite efforts in 2009 legislation to remove constraints on sharing examinations with other regulators, there are many other existing confidentiality provisions that contradict the new provision. When Senator Hassan asked Deputy Commissioner Fleury at the June 21, 2010 hearing whether Banking could envision having different confidentiality provisions for mortgage broker examinations than for banks given the smaller size of the companies and looser nature of the business, he responded that, " [m]y opinion is that we need to march down that road very carefully, very slowly, because it has significant unintended consequences that we need to be aware of." While understandable, this reflects the continuation of a very conservative approach to information sharing that worked against regulatory agencies and the public in the FRM matter.

[55] While Commissioner Hildreth reported that he told people both at Securities and then at Banking about his conflict and recusal, the notification that he made did not appear to result in adequate safeguards or changes in responsibility that might have avoided some of the operational failures noted in this report.

D. Statutory Reform regarding Banking Department's Authority

1. Scope of Banking Department Examination

***Recommendation 1:***

***The Legislature should consider expanding the scope of its examinations by removing any ambiguity as to whether the Department of Banking when conducting an examination or investigation has the authority to examine the financial condition of the entity's entire operations, not merely the activities which are the subject of the regulatory authority.***

State law requires that the Commissioner of Banking examine the condition and management of all the institutions under his jurisdiction at least every 18 months, except for highly rated institutions.[56] Pursuant to this duty, the Banking Department conducted examinations of FRM in 2001, 2003, 2004, 2006, 2007, 2008 and 2009.

Bankings examinations of FRM found repeated violations of the law, resulted in multiple referrals for enforcement and in 2006 the Department issued an order to show cause why FRM's license should not be revoked. For reasons discussed elsewhere, the license revocation proceeding was closed in 2007 without being pursued fully.

During Banking Department testimony there appeared to be some uncertainty regarding the scope of the examination into the condition of the licensee. Commissioner Hildreth indicated that the Banking Department would only have the authority to look into the financial condition of the licensee's residential mortgage business.[57] Other Banking Department staff indicated that an examination would look into the entire net worth of the licensee across all of its financial activity.[58] Attorney Head of the Department of Justice agreed that in a case like FRM, where the licensed and unlicensed portions of the company's business is commingled in its records, the Banking Department has the authority to examine the totality of the companies activities.[59] However, he was of the opinion that:

[56] RSA 383:9
[57] Testimony of Peter Hildreth, May 14, 2010, p. 175.
[58] Testimony of Mary Jurta, May 14, 2010 p.176. Ms. Jurta pointed out that in relation to the FRM matter, most of the funds flowed not through FRM itself, but through CL&M, which served as the loan servicer for FRM. CL&M was not registered as a loan servicer, in spite of its duty to be registered, and thus was never subject to a full examination by the Banking Department. The Banking Department did have authority under 397-B:9-a to conduct an examination of a mortgage servicer who should have been registered under RSA 397-B but who had not in fact registered as required, but did not conduct such an examination.
[59] See Richard Head Testimony, May 21 2010, p. 99 – 100.

> I think it does become tougher in terms of a legal analysis if the business maintained separate books, maintained separate records, maintained separate personnel, maintains an appropriate separation of the licensed and unlicensed activities as to whether or not the Banking Department would have the jurisdiction to do an examination of the completely separate, although same name, but completely separate operation. I think that's a far more difficult question and is ambiguous within the way the statute is currently written and that is an area in which legislative clarification would be appropriate.[60]

Amendments to RSA 397-A:5, III(c) enacted in 2009 have begun to address this ambiguity. The 2009 amendment now requires that:

> Each mortgage banker or mortgage broker applicant shall be required to submit to the department detailed financial information sufficient for the commissioner to determine the applicant's ability to conduct the business of a mortgage banker or a mortgage broker with financial integrity. The mortgage broker's application shall include a statement of net worth prepared in accordance with the generally accepted accounting principles. The mortgage banker's application shall include a balance sheet, income statement, cash flow statement, statement of owner's equity, and note disclosure, and shall be prepared in accordance with generally accepted accounting principles.

The amendment requires that during an examination or an investigation, "net worth statements provided in connection with a license application shall be subject to review and verification." [61]

The Legislature should remove any ambiguity as to whether the Department of Banking when conducting an examination or investigation has the authority to examine the financial condition of the entity's entire operations, not merely the activities which are the subject of the regulatory authority. Legislative consideration of this issue should also include the impact on staffing at the Banking Department and the relative burden that the expanded scope might impose on regulated entities.

[60] Id.
[61] RSA 397-A:5.

2. Confidentiality of Banking Documents

***Recommendation 2:***

***While the provisions required by the SAFE act contained in RSA 397-A:12-a should not be amended, the committee recommends that the Legislature clarify the confidentiality and information sharing statues that apply to the Banking Commissioner. In particular, the Legislature should consider:***

***a) Clarifying whether examinations pursuant to RSA 397-A:12 may be publically released pursuant to RSA 383:10-b.***

***b) Providing criteria to guide the discretion of the Banking Commissioner as to when information should be released to the public pursuant to RSA 383:10-b because the "ends of justice and the public advantage will be" served.***

***c) Expressly requiring the sharing of information by the Banking Commissioner with certain state regulators including the Attorney General and the Bureau of Securities Regulation.***

***d) Adopting less stringent protections against the release of information as it pertains to the non-chartered and/or non-depository institutions under the Banking Department's authority. The private information of individuals would still need to be protected for all institutions. The legislature may want to consider different confidentiality standards for the Banking Division versus the Consumer Credit Division of the Department.***[62]

The regulatory response to the FRM matter highlights the need for information sharing between the various regulators and with the public. Unfortunately, statutory provisions keeping Banking Department records confidential appear to have hindered needed information sharing with other regulators, including the Bureau of Securities Regulation. As the activities of regulated entities become more complex and span across the jurisdiction of various regulators it is imperative that a system of effective information sharing exist between the different regulators.

There are multiple and at times conflicting banking statutes regarding confidentiality and information sharing.

RSA 383:10-b, provides that:

[62] See discussion between Sen. Hassan and Robert Fleury, June 21, 2010 Hrg. Transcript p. 94-95.

> All records of investigations and reports of examinations by the banking department, including any duly authenticated copy or copies thereof in the possession of any institution under the supervision of the bank commissioner, shall be confidential communications, shall not be subject to subpoena and shall not be made public unless, in the judgment of the commissioner, the ends of justice and the public advantage will be subserved by the publication thereof. (emphasis added)

It was pursuant to the authority provided in this statute that Commissioner Hildreth finally released the examination reports of FRM on December 21, 2009, finding that "the ends of Justice and the public advantage will be subserved" by their publication.[63]

In addition to this general statute, RSA 397-A has three separate provisions dealing with confidentiality and information sharing. RSA 397-A:12 V-a provides that:

> "to avoid unnecessary duplication of examinations and investigations, the commissioner, insofar as he or she deems it practicable in administering this section, may cooperate and share information with the regulators of this state and other states, the Federal Trade Commission, the Department of Housing and Urban Development, other federal regulators, or their successors in conducting examinations and investigations."

This statute was originally inserted in 2005 and then amended in 2008 to specifically add the ability to share the information of investigations and to share all the information with regulators from this state. Like the general banking statute, information sharing with other interested regulators is left to the discretion of the Banking Commissioner.

RSA 397-A:12 X provides that: "All reports pursuant to this section [on examinations] shall be absolutely privileged and although filed in the department as provided in paragraph IX shall nevertheless not be for public inspection. The comments and recommendations of the examiner shall also be deemed confidential information and shall not be available for public inspection." This provision was enacted in 2003 and appears to limit the public release of the information. Its applicability to sharing information between agencies is ambiguous.

[63] Order issued by Peter Hildreth, Bank Commissioner, December 21, 2009, releasing the NH Bank Department Reports of Examinations of FRM from 2001, 2003, 2004, 2006, 2007 and 2008, with the names of borrowers redacted.

Finally in 2009, confidentiality and information sharing language was added to the chapter as required by the federal S.A.F.E. Mortgage Licensing Act. As described by the Attorney General report, this new language "authorized the commissioner to enter agreements or sharing arrangements with other governmental agencies, the Conference of State Bank Supervisors, the American Association of 31 Residential Mortgage Regulators, or other associations representing governmental agencies regarding information on the Nationwide Mortgage Licensing System and Registry. It also made explicit that the Banking Department could share information with law enforcement agencies for the purpose of criminal investigations."[64]

The existence of these multiple provisions creates significant confusion as to what the commissioner can share, under what circumstances and with whom. For example, it appears that RSA 397-A:12, X would prohibit the public release of any examination conducted on a mortgage banker or broker, yet on December 21, 2009 the Banking Commissioner released a series of these examinations pursuant to his authority under RSA 383:10-b upon a finding that it would serve the ends of justice and a public advantage.

The legislature needs to clarify the confidentiality and information sharing statues that apply to the Banking Commissioner.

## VII. Bureau of Securities Regulation

### A. The New Hampshire Securities Act

The regulation of securities is governed by RSA 421-B, which is the Uniform Securities Act as adopted by New Hampshire. Although the statute was modeled on the Uniform Act, there are features of the law that are unique to New Hampshire. The Bureau of Securities Regulation ("BSR") within the Secretary of State's Office administers the State's securities laws. Based on its own report dated April 22, 2010, the Bureau has five primary functions that are designed to protect investors in securities:

- licensing of firms and individuals,
- examination of firms and individuals,
- registration of securities,
- investor education and
- enforcement.

[64] Attorney General Report, p. 30.

The regulatory scheme embodied in RSA 421-B covers a number of different topics, including:

- licensing requirements for broker dealers, issuer dealers, investment advisors and agents;
- the examination of licensed entities;
- prohibitions on fraud and unlawful activities in the sale of securities;
- requirements for the registration of securities: and
- review of advertising materials related to registered securities.

The Bureau of Securities Regulation is provided broad administrative powers including the power to investigate, issue subpoenas, issue cease and desist orders, seek fines, seek restitution or disgorgement, and to impose criminal penalties, and civil liabilities.[65]

The statute makes it is unlawful for any person "to offer or sell any security in this State unless the security is registered under this chapter, . . . exempted under RSA 421-B:17," or is a compliant federal covered security. Identifying what is a security covered under the statute is critical to establishing the jurisdiction under state Securities Act.

It is important to point out that the definition of a security in the Act includes a long laundry list of items.[66] RSA 421-B:2 defines a "security" as a "note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; membership interest in a limited liability company" or "investment contract," among other items. For purposes of the issues related to FRM, it is most important to mention that the definition includes "notes." The statute then identifies a few expressly excluded items that are not securities under the act, even if they fall under the general definition of a security. These express exclusions, none of which are relevant to the FRM matter, are for insurance and endowment policies or annuity

[65] RSA 421-B:11

[66] See RSA 421-B:2 XX(a): "Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit sharing agreement; membership interest in a limited liability company; partnership interest in a registered limited liability partnership; partnership interest in a limited partnership; collateral trust certificate; preorganization certificate or subscription; transferable shares; investment contract; investment metal contract or investment gem contract; voting trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas or mining right, title or lease or in payments out of production under such a right, title or lease; or, in general, any interest or instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

contracts provided by an insurance company, membership in applicable LLCs and interests in qualifying partnerships.[67]

Finally, the Act also contains an extensive list of "exempt" securities, which are exempt from registration requirements but still subject to the anti-fraud provisions of the act.[68] The anti-fraud provisions in the statute are extensive. They prohibit the use of any device, scheme, or artifice to defraud. This would include making untrue statements of material fact or engaging in any act or practice or course of business which operates as a fraud or deceit.[69] The burden of proving that an instrument is not a security, or is an exempt security, rests with the party claiming the exclusion or the exemption.[70]

Throughout the hearings, the most highly contested issue discussed by witnesses from Banking, Securities and the Attorney General's Office was whether various notes (or interests in trusts which held the notes) issued by FRM constituted loan documents that were not covered by the act or whether they were securities. The answer to this question determines whether the Bureau of Securities Regulation had jurisdiction over FRM during the later period of its operation when it was allegedly operating a Ponzi scheme.

B. Actions and Testimony of the Bureau of Securities Regulation

1. History of BSR Complaints and Enforcement Activities

As of April 2000, Attorney Steven Latici had filed a complaint against FRM with BSR which alleged violations of the securities laws. He alerted BSR to his concern that FRM was involved in a Ponzi scheme because FRM was selling unregistered securities and not segregating investors' funds.[71]

Jeffrey Spill, a Hearings Officer for BSR, testified that after he arrived in the Bureau in November 2000 and received a follow up call from the complainant's attorney requesting information regarding the status of the complaint, he could not even find the file on the complaint.[72] He testified that after looking into the matter, it was clear that the 2000 complaint did involve securities as FRM was raising capital though individual

[67] See RSA 421-B:2, XX (a) and (b).
[68] See 421-B:17.
[69] See RSA 421-B, Sections III, IV and V.
[70] See RSA 421-B:11 (I-b) (c) and RSA 421-B:17 (v).
[71] Report of the Attorney General at p. 2.
[72] May 14, 2010 Hrg. Transcript at p. 22.

investors who provided cash and received back stock or unsecured promissory notes.[73] As a result, BSR issued a 2001 Cease and Desist Order for unregistered securities activity.[74]

In September 2002, the original complainant withdrew her complaint and the BSR contacted the Attorney General's Office for guidance on how to proceed with the administrative action against FRM.[75] Mr. Spill testified that the Office suggested that the BSR contact the investors, let them know where things stood and try and put Financial Resources in a position where they could payback all the investors.[76]

While the BSR was moving forward on an action addressing the sale of unregistered securities, Mr. Spill considered the issue and concluded that there was not a Ponzi scheme. After the original complainant settled her court case and withdrew her complaint, BSR was looking for a "replacement complainant."[77] Mr. Spill recounted his conversations with investors as follows:

> [W]e were looking for what's called a replacement complainant. Somebody to take the case of fraud to the hearing process. We couldn't make that case because the people who we're speaking to said we are fine with Scott Farah. No problem with Scott Farah. Did he misrepresent anything to you? No. One fellow said he thought he was an honorable guy. I asked him, do you think you were lied to? No. [Were] there misrepresentations made to you about where the money was going to go? At one point, one of the investors said we didn't care where the money went as long as we had our interest. We didn't know what he was doing with the money and we didn't - - - that wasn't part of the bargain.[78]

Based on his understanding that in order to constitute a Ponzi scheme the business had to be a fraud from the start, Mr. Spill reached a conclusion that this was not a Ponzi scheme.[79] He also concluded that the anti-fraud provisions of the Securities Act "requires you to have a victim…requires you to have somebody say I was defrauded."[80] Thus, the BSR enforcement action only addressed the sale of unregistered securities.

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[73] May 14th Hrg. Transcript at p. 22.
[74] May 14th Hrg. Transcript at p. 10.
[75] May 14th Hrg. Transcript at p. 24
[76] May 14th Hrg. Transcript at p.24
[77] May 14th Hrg. Transcript at p. 27.
[78] May 14th Hrg. Transcript at p. 27.
[79] Id. Mr. Spill later added that, in making this determination, "We talked to the investors. We got check registers. We didn't actually look at the notes and mortgages because we believed it's not in our jurisdiction." May 14th Hrg. Transcript at p. 31.
[80] May 14th Hrg. Transcript at p. 27.

After issuing the Cease and Desist Order in 2001, the Securities Bureau conducted discovery and a limited investigation, and engaged in settlement negotiations.[81] Mr. Spill testified that there was some limited progress in getting FRM to pay back the investors, but by January 2003, BSR decided that time was up and that they were going to go to a hearing against FRM.[82] He reported that FRM's counsel was concerned that FRM did not have the funds to pay back all the investors. Mr. Spill testified that he was not able to obtain banking examination reports and bank records for FRM in 2003, despite his requests.[83]

On June 17, 2003, BSR sent the Attorney General's Office a letter requesting their assistance in freezing assets for the benefit of the investors and noting the date of the hearing in July. BSR staff believed the attempt to freeze assets was necessary before the administrative hearing. However, no response was received prior to the hearing date. While there is no record of a written response from the DOJ, BSR testified that they were provided a verbal response indicating that the Attorney General would not be attempting to freeze assets.[84]

On July 24, 2003, the BSR held a hearing on the complaint against FRM. However, the Hearing Officer never issued an opinion following the hearing. Mr. Spill explained the impact of not receiving a decision and the reasons for inaction as follows:

> So we waited for a decision, and the decision didn't come. And I didn't know why. You know, I reported it to my supervisor. And time went on. And again, the fact that time is going on presents a problem because when you go into court and you ask for something like an injunction or an asset freeze, it's an emergency request. You're saying you have to act now to prevent further harm. So as time goes on, it be very difficult without a decision, with a hearing without a decision to then go in Superior Court and say this is an emergency. Because it wasn't an emergency. Time had gone by. And during this time the debt had been . . . the attorney for Financial Resources had been working on reducing that debt during that time period. So that even lessens the urgency. So looking back on it, understanding now what the problem was, apparently the hearings examiner felt that if he ordered the full rescission, investors would be left out in the cold because the money just wasn't there. So he would want to

[81] Attorney General Report at p. 2.
[82] May 14th Hrg. Transcript at p. 24.
[83] May 14th Hrg. Transcript at p. 29.
[84] May 14th Hrg. Transcript at p. 25. The Attorney General's Office has noted that neither BSR nor its Office had authority to request an asset freeze until the end of August 2003.

> set up a scenario where the company would have a, I guess, an opportunity to payback in a timed way the investors.[85]

In late 2005, the Bureau received a call regarding FRM selling an individual named Stone an interest in a company that may have been dissolved.[86] Mr. Spill testified that Mr. Stone did not file a formal complaint and, thus he believed that BSR's authority in the matter was limited.[87] Apparently recognizing that the participation notes involved in Mr. Stone's case constituted securities, Mr. Spill became concerned about whether the original Cease and Desist Order applied to the new matter or whether it had become stale over time.[88] At least in part based upon these concerns, it appears that the Stone matter was later rolled into the negotiated Consent Agreement in 2007.

In 2006, when BSR obtained updated financial reports for FRM, it appeared that the company had made significant process on its debt. However, BSR later learned that "the 2005 financial statements were fraudulent . . . They were a lie because the line of credit that went from CL & M to Scott Farah, Financial Resources, was consummated in June of '05. That was not in the financial statements."[89] Based on the financial statements provided by FRM, BSR had believed the company was making progress.

In April 2006, the Banking Department invited BSR to participate in a joint examination of FRM. The BSR declined the invitation and did not participate in the examination.[90] Mr. Connolly testified that the BSR did not have the statutory authority to audit FRM in 2006.[91]

In 2007, BSR resolved the 2000 complaint and the Stone matter by executing a Consent Agreement with FRM. The Consent Agreement prohibited FRM from engaging in securities activity in the future.[92] The agreement provided for full restitution being paid to all thirty-five (35) investors covered in the Agreement.[93]

Mr. Connolly testified that it was not until FRM closed its doors that the Bureau became aware that FRM violated the Consent Agreement by becoming involved with

[85] May 14th Hrg. Transcript at p. 26.
[86] May 14th Hrg. Transcript at p. 28.
[87] May 14th Hrg. Transcript at p. 26.
[88] May 14th Hrg. Transcript at p. 30.
[89] May 14th Hrg. Transcript at p. 29.
[90] May 14th Hrg. Transcript at p. 7
[91] Id.
[92] May 14th Hrg. Transcript at p. 10
[93] AG report p. 23.

three securities offerings during 2008 and 2009. [94] BSR staff testified that it did not have the authority to verify compliance with the 2007 Agreement which prohibited FRM from selling unregistered securities.[95]

2. BSR's Opinion of What Constitutes a "Security" Subject to the Act

Prior to the issuance of the Attorney General's Report in May 2010, then Securities Director Connelly issued his own report detailing the Bureau's actions with respect to FRM and reaching findings with respect to the roles played by the Bureau, the Banking Department and the Attorney General's Office with respect to FRM. That report discusses in detail the BSR's interpretation of its jurisdiction and regulatory authority with respect to the loan and investment instruments utilized by FRM.

During the May 14, 2010 hearing, Mr. Connolly expressed surprise that so much attention was paid to the role of Securities Regulation in connection with FRM.[96] Mr. Connelly testified that he believed that the vast majority of transactions undertaken by FRM and related businesses such as CL & M were not subject to State Securities laws. He expressed a narrow interpretation of what constitutes a security in New Hampshire, stating that:

> These laws do not currently provide for the licensing of persons who deal in mortgages, the examination of such persons, or the registration of notes secured by a mortgage offered in origination. To conclude otherwise would mean both the Securities Bureau and Banking Department would both have to register, license, and audit all mortgage activities in New Hampshire.[97]

According to Mr. Spill, the Securities Bureau never viewed notes and mortgages as securities.[98]

During the May 14th hearing, Senator Reynolds inquired as to the BSR's understanding of whether the pooled investment instruments with a fixed rate of return constituted "securities-like" instruments under the New Hampshire securities regulation

[94] May 14th Hrg. Transcript at p. 10-11. Mr. Connolly stated that these three securities were the subject of the federal criminal and SEC complaints.
[95] May 14th Hrg. Transcript at p. 81.
[96] Contrary views of the facts and circumstances related to BSR's scope of jurisdiction and actions with respect to FRM may be found in the Attorney General's Report and the Report issued by the Banking Department in response to BSR's report. Among other issues, the Attorney General's Office focuses on the BSR's lack of investigation and prosecution of matters that came to light in 2006, leading to the Banking Department's call for a joint examination.
[97] May 14th Hrg. Transcript at p. 10
[98] May 14th Hrg. Transcript at p.21.

scheme, as opposed to cases where someone simply acted as a lender.[99] Mr. Spill responded that he did not believe that those pooled investment vehicles were securities in New Hampshire.

Mr. Spill clarified in later testimony that New Hampshire's whole mortgage exemption precluded a finding that pooled investment instruments were securities in situations where individuals who loaned money through FRM were given interests in trusts. Because, in those instances, the trust held the note and mortgage in whole, the interests conveyed in the mortgage were not fractionalized, but, rather, constituted participations.[100] In support of his position that these interests were not securities, Attorney Spill pointed to a case entitled Manchester Bank v. Connecticut Bank and Trust, which stated that a participation in a note and mortgage was not a security.[101]

In follow up testimony provided by Secretary of State William Gardner on June 17, 2010, Secretary Gardner testified that:

> [m]ortgages and participations would not be considered a security unless the mortgages were bundled and sold in a mutual fund or some other vehicle in a secondary market subsequent to the . . . origination of the loan.[102]

Secretary Gardner stated that, following the passage of RSA 421-B, mortgages were never treated as securities under the Act. He expressed his opinion that the Attorney General's interpretation that certain transactions were securities "turns upside down half a century of the way regulation has been conducted in this state."[103] He noted:

> [A] security has to be four things. It has to be an investment of money. It has to be in a common enterprise. It has to be with the expectation of

[99] May 14 Hrg. Transcript at p. 41.
[100] May 14 Hrg. Transcript at p. 84.
[101] May 14, 2010 Hrg. Transcript at p. 84. Attorney Frydman pointed out that the Manchester Bank case was decided before RSA 421 was repealed and replaced with RSA 421-B. Mr. Spill's testimony on this issue is consistent with his statements in a September 21, 2006 letter to FRM's attorney, in which Mr. Spill stated that, "there are more 'participation notes' than was first represented during our audit of 5/19/2006 . Given that all of these notes were not actually secured mortgages, they are securities having no registration or exemption. Moreover it appears that some of these notes were issued after the hearing held on 7/24/2003, a time when Mr. Farah would have or should have known that distribution of such notes would be in question. Attorney General Report at p. 23.
[102] Jun 17, 2010 Hrg. Transcript at p. 12.
[103] Jun 17, 2010 Hrg. Transcript at p. 13.

> profit. And it has to have managerial efforts that come from someone other than the investors.[104]

In response to further questions, Secretary Gardner responded that "[a] group of people that . . . have shares can join together, form a trust and take ownership of a company [-] because they have a majority of the stock, that does not make them a security."[105] He added that you have to have the instrument. Professor Joseph Long, Acting Director of the Bureau of Securities Regulation, agreed that a trust only becomes a security when it meets the criteria described by Secretary Gardner. With respect to the FRM investor/lenders, "[t]hey got an interest in the loan. Then the trust was formed in order to put the mortgage into the trust for administrative purposes."[106] Based on the basic rules of securities regulation, "you don't look at the document. You look at the substance of the transaction."[107]

As illustrated in the respective testimony and as described in this report, the Bureau of Securities Regulation and the Attorney General's Office fundamentally disagreed about what constitutes a security under New Hampshire law.

3. Testimony regarding BSR's Investigative and Examination Powers

Speaking in response to findings in the Attorney General's report, Mr. Connolly pointed out that the Bureau did not have authority to conduct an examination of FRM, which was not a licensed entity for purposes of securities regulation.[108] He stated that in order to conduct a joint examination with Banking in 2006, BSR would have to have obtained permission from FRM, which would have undermined the surprise nature of the visit proposed by Banking or, if conducted solely under the authority of Banking, would have limited the Bureau's use of any materials that came to light.[109]

The Attorney General's Report concurs that the BSR's authority to conduct an *examination* was limited to only licensed entities until 2007. However, in 2007, the Securities Act was amended to allow BSR to audit those "licensed or required to be licensed" under the Act. Furthermore, the Attorney General's Office testified that that

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[104] Jun 17, 2010 Hrg. Transcript at p. 14.
[105] June 17, 2010 Hrg. Transcript at p. 29.
[106] i.e. For ease of administration in the event of foreclosure.
[107] But see contrary points of view expressed by the Department of Justice, Attorney General Report at pp. 26-27 and Appendix B; and by the Banking Department at May 14, 2010 Hrg. Transcript137-139.
[108] May 14, 2010 Hrg. Transcript at p. 7. The Attorney General's Report notes that this was true until 2007. In 2007, the Securities Act was amended to allow BSR to audit those "licensed or required to be licensed" under the Act.
[109] May 14th Hrg. Transcript at p. 7.

prior to 2007 while the BSR did not have the authority to audit entities that were not licensed with them, they had extensive investigative powers, including the right to compel records and witness testimony, in order to determine if violations of the Security act had occurred.[110]

4. BSR's Lack of Information from Department of Banking

The Bureau of Securities Regulation was very vocal about its dissatisfaction with Banking's responses to its requests for records over the years. Both in his report and in his testimony before the Committee, Mr. Connelly expressed frustration at being denied access to FRM records obtained in the course of regular examinations by the Banking Department.[111] The Bureau was told on several occasions that it could not have access to the records due to legal requirements to maintain confidentiality. When asked by Senator Hassan how he would balance the needs for confidentiality presented in the different regulatory schemes, Mr. Connolly distinguished between the confidentiality that should be extended to bank records in the depository context, versus records relating to the mortgage brokerage business.[112] Particularly where a mortgage company was no longer in business, Mr. Connelly questioned whether any purpose was served in not releasing its records.[113]

C. Analysis of BSR's Management and Operational Functioning

Based only upon the testimony provided by the Securities Bureau, it is clear that FRM presented particular challenges from a securities regulation standpoint based in large part upon the Bureau's understanding of its jurisdiction and authority. To the extent that FRM's business involved mortgage banking and brokerage activities regulated by Banking, this was unfamiliar territory for the Bureau. Mr. Spill testified that BSR "didn't typically examine mortgage companies."[114] To the extent that the Banking Department took the position that it could not share its records, and to the extent that the Bureau's jurisdiction to conduct examinations extended only to licensed entities until 2007, it was, at least to some degree, stymied in its efforts to pursue documentation regarding FRM that might have clarified the nature of FRM's business dealings. For its part, FRM used its status as a licensed mortgage broker as a shield, claiming that it could not provide documents that were subject to confidentiality under the Banking laws.[115]

[110] Testimony of Richard Head, May 21, 2010 Hrg Transcript at p.23; Attorney General Report pp. 23-24.
[111] May 14, 2010 Hrg. Transcript at p. 12.
[112] May 14, 2010 Hrg. Transcript at p. 72-73.
[113] Id.
[114] May 14, 2010 Hrg. Transcript at p. 30.
[115] Attorney General Report at p. 18.

During the hearings, there were many references to transactions and documents that "were neither fish nor fowl." Given the changing landscape of mortgage transactions and investment vehicles during the operative timeframe, and the fact that FRM operated to some extent on the margins of regulation provided by banking and securities laws, the situation presented a ripe opportunity for regulatory failure.

**Finding 1: BSR failed to appropriately pursue FRM after receiving notice of fraudulent and illegal activities.**

The Bureau's most obvious regulatory failure was its failure to appropriately pursue the company after receiving notices in 2005 and 2006 that FRM had advertised a fraudulent investment opportunity. In 2006, the Bureau also received evidence that FRM had committed new violations of its administrative order. It knew at this point that FRM was in financial trouble. Rather than pursue the new matters aggressively, the Bureau concentrated its efforts on wrapping up its 2001 case in a belated 2007 Consent Agreement.[116]

The lack of an appropriate response to complaints also occurred after it received the initial complaint in 2000. The Bureau allowed more than eighteen (18) months to pass from the time it received the initial complaint from Attorney Latici to the time it issued an administrative order against Scott Farah, Gary Coyne and FRM.[117] Another fourteen (14) months passed before a hearing was held on the violations giving rise to the order. No decision was ever rendered by the Hearing Examiner and the case was administratively resolved in 2007 with funds that seemingly appeared from out of nowhere.

To be fair, there is certainly evidence that the Bureau attempted to address violations committed by FRM within the perceived limits of its authority. The Bureau brought an enforcement action against FRM in 2001. It was the only State agency to do so and to follow its action through to a conclusion. It pursued settlement negotiations and held a hearing on the violations. It sought assistance from the Attorney General's Office in an effort to protect the assets of investors in the company. It is unclear why the Bureau's efforts were less robust in 2005 and 2006 when additional reports of fraud and non-compliance were received.[118] While there is agreement that constraints on the Bureau's ability to audit FRM existed prior to 2007, it seems clear that, as of 2006, the Bureau had actual evidence of new violations of the New Hampshire Securities Act. BSR does not appear to have lacked resources, as it aggressively pursued enforcement

[116] May 21, 2010 Hrg. Transcript at p. 27
[117] Attorney General Report at pp. 18- 19.
[118] Concerns about delay and the lack of a decision in the original case appear to be a factor.

actions against licensed entities. More than anything else, BSR appeared to be constrained in pursuing FRM based upon perceived limitations of its authority.

**Finding 2: BSR's arguably narrow view of its investigative and enforcement authority prevented it from taking effective action**

The Bureau appeared to take a very narrow view with respect to its investigative and enforcement authority, which explains why it simply pursued securities violations in 2001 when confronted with evidence of fraud and commingling of funds.[119] Likewise, it failed to utilize its investigative authority when presented with allegations and evidence of fraud prior to 2007. After 2007, the law changed and the Bureau had the authority to audit entities which should have been licensed under the securities statute but were not. After 2007, this applied to FRM as it was engaging in the unregistered sale of securities. BSR's limited view of its investigative and enforcement authority prevented it from following up on the FRM Consent Agreement to ensure compliance with that agreement.

The Bureau also failed to take advantage of Banking's offer to conduct a joint examination in 2006. While it is correct that under the law in 2006, BSR may not have had the authority to conduct a formal audit or examination of FRM, it certainly had the authority to investigate the complaints against FRM raised in 2005 and 2006. If it had not applied an overly restrictive interpretation of it investigative powers, the Bureau could have worked with Banking to investigate those complaints.

**Finding 3: BSR's arguably narrow view of which of FRM's investment and lending vehicles constitute a security under NH law appeared to make it easier for FRM to perpetrate its illegal behavior**

As described in more detail in the jurisdictional section of the report, legislative action is needed to clarify the scope of BSR's authority with respect to examinations of unlicensed entities. While there was some clarification in 2007, there appears to be conflict as to the intent and effect of that change. Legislative action is also needed to clarify what constitutes a regulated security under New Hampshire law. Of particular interest is the question of whether notes secured by mortgages may ever constitute securities under New Hampshire law. Along the same lines, there will need to be clarification of whether fractionalized interests or participations in mortgage instruments, held in trust or otherwise, may constitute securities under New Hampshire law. While there is certainly disagreement among the agencies on these threshold issues, it seems

[119] The Attorney General's Report notes that Attorney Spill does not agree that there was "any indication of widespread fraud or an ongoing Ponzi Scheme," either in 2000 when BSR received a complaint or later when it conducted a hearing on the complaint. Report at p. 17, Footnote 30.

clear that the public will be best served by a regulatory scheme that is flexible enough and has enough redundancy to address emerging issues in this evolving area.

**Finding 4: BSR failed to manage and supervise the work of its hearings officer**

The Bureau suffered from a misperception of its ability to manage the work of its Hearing Examiner. According to the testimony of Mr. Connelly, the agency did not feel that it could interfere in any way with the decision-making process engaged in by the Hearing Examiner.[120] As pointed out in the Attorney General's Report, although an agency may not attempt to influence the outcome of a particular proceeding, it may certainly establish appropriate controls and exercise supervision to ensure that decisions are rendered in a timely fashion.

There are many reasons why it is unacceptable for an agency to hold a hearing and never render a decision on the matter. Once a matter goes to hearing, a decision should be rendered in accordance with appropriate statutory standards. With respect to management of hearing examiners, to the extent that full-time staffing is considered necessary, legislative support is essential.

D. Statutory Reform regarding BSR's Authority under the NH Securities Act

1. Clarifying what is a security

***Recommendation 1:***

***The Legislature should clarify what constitutes a security under the New Hampshire Securities Act.***

The FRM matter has highlighted significant differences in various agencies' interpretation of what is considered a "security" in New Hampshire. In reviewing the FRM matter, the Bureau of Securities Regulation (BSR) and the Office of the Attorney General (AG) have issued competing interpretations as to what constitutes a security under New Hampshire law and whether the different lending and investment vehicles utilized by FRM were covered by the registration and/or anti-fraud provisions of the state Securities Act. Since the jurisdictional authority of the Bureau of Securities Regulation

[120] May 14, 2010 Hrg. Transcript at p. 46. Mr. Connelly further testified that the Attorney General's Office did not give him the advice that appears in its report at the time that this issue arose.

is based on the extent that the different instruments are covered under the act, it is imperative that the present ambiguity be resolved.

According to Professor Joseph Long, the expert for the BSR and now Acting Director for the Bureau, the New Hampshire statute contains a unique provision which he interprets as creating an implied exclusion from all regulation (registration and anti-fraud) under the Securities Act for the primary or original offer and sale of a promissory note coupled with a whole mortgage. The current law contains no language creating this exclusion, even though other express exclusions are included in the statute. Professor Long argues that since there is an express exemption from the registration requirements under the act (but not the anti-fraud provisions) for the secondary sale of a promissory note coupled with a whole mortgage sold to a single purchaser at a single sale, it only makes sense (logically and based on NH history) that there is an implied exclusion for the primary sale as that is the less risky transaction of the two types of transactions. The BSR relies on this opinion, offered after the fact, in defending its conclusion that the lending/investment vehicles utilized by FRM were not under its regulatory jurisdiction.[121]

In contrast, the Attorney General's Office relying upon its expert, Attorney Michael Krebs of the Nutter McClennen firm, rejects the implied exclusion theory. Instead, he believes that FRM may have utilized at least three types of "securities" subject to the Securities Act, and thereby to BSR regulatory jurisdiction. These include ownership interests in trusts, investment contracts and certain promissory notes. [122]

It is beyond the scope of the committee to resolve this legal disagreement. However, the existence of contradictory legal opinions is sufficient to conclude that the legislature must clarify the state Securities law in order to remove the current ambiguity. What is a "security" subject to the state securities act is, in the first instance, a public policy decision properly within the purview of the legislature.

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[121] In testimony, Professor Long acknowledged that even if his implied exclusion exists, some of the "hypothetical" categories of lending transaction described by the Attorney General as being representative of FRM's activities may have been securities under the act subject to the anti-fraud provisions of the act and possibly, in the case of certain trusts, the registration requirements under the act. Note, however, that Professor Long would only treat the examples as hypothetical because he was unaware as to whether they accurately reflected the types of lending vehicles utilized by FRM. See June 17, 2010 Hrg. Transcript at pp. 62-82.

[122] See Report of the Attorney General to the Governor and Executive Council on Financial Resources Mortgage, Inc., May 12, 2010, P. 26-28 , Appendix B, and Nutter Memo to Richard Head dated May 12, 2010.

2. The exemption for loans secured by mortgages

The amendment to the law must not only add clarity but must be able to respond appropriately to the increased use of ever more complex investment and lending vehicles. While the experts for the BSR and the AG differed over the interpretation of existing law, they seemed to agree that adoption of section 202(11) of the Third Model Securities Act would serve New Hampshire well.

The recommended provision would replace the current exemption in RSA 421-B:17 (II)(d) and thereby eliminate the distinction between primary and secondary sale notes coupled with mortgages and the basis for Professor Longs argument for the existence of an implied exclusion.[123]

***Recommendation 2a:***

***The Legislature should update the exemption for loans secured by mortgages to respond to the increased use of more complex investment and lending vehicles.***

***Revisions could be achieved by replacing RSA 421-B:17 (II)(d) with the following:***

***"II. The following transactions are exempted from RSA 421-B:11 and RSA 421-B:18, I:***

***(d) A transaction in a note, bond, debenture or other evidence of indebtedness secured by a mortgage or other security if:***

> ***(1) the note, bond, debenture, or other evidence of indebtedness is offered and sold with the mortgage or other security agreement as a unit;***
> ***(2) a general solicitation or general advertisement of the transaction is not made; and***
> ***(3) a commission or other remuneration is not paid or given, directly or indirectly, to a person not registered under this act as a broker-dealer or as an agent."***

The Legislature should consider adding a fourth condition to the availability of this exemption which would require that the debt that is secured by the mortgage not exceed the fair market value of the collateral. This additional condition has been added

[123] Nevertheless, the elimination of the current exemption in RSA 421-B:17 should be accompanied by some legislative history to make it clear that there is no intent that there exists an implied exemption for original issuer notes coupled with whole mortgages.

by the state of Maine. It too would address one of the allegations in the FRM matter; it is claimed that some of the lenders provided funds for loans based on appraisals that overstated the fair market value of the security provided.

***Recommendation 2b:***

***The Legislature should also update the exemption for loans secured by mortgages to ensure that the principal amount of all notes or other evidence of indebtedness or other security agreement does not exceed the fair market value of the property at the time of the transaction. Language to accomplish this could read as follows:***

> **(4)** ***The outstanding principal amount of all notes or other evidence of indebtedness that is secured by the mortgage or other security agreement does not exceed the fair market value of the property at the time of the transaction, or the issuer otherwise proves that it relied on reasonable evidence that the fair market value was not so exceeded at the time of the transaction.***

3. Applying a Contextual Analysis to the Application of the State Securities Act.

***Recommendation 3:***

***In order to facilitate regulation of evolving and complex instruments without placing undue regulatory demands on ordinary course of business transactions, the Legislature should clarify how the "context" of a transaction should be analyzed to determine the security status of an instrument under the Securities act. The Legislature should consider expressly adopting the "Family Resemblance Test" as articulated in the Reves decision, a test supported in testimony by both BSR's and the DOJ's expert.***

In addition to updating the exemption to the Securities Act for notes secured by mortgages, both experts stressed the importance of applying a contextual analysis to the determination of what constitutes a security in NH. The current New Hampshire Securities Act recognizes the importance of contextual analysis by prefacing the definition section with the following caveat: "When used in this chapter, unless the context otherwise requires."[124] However, guidelines for applying this contextual analysis have not been adopted in our state.

[124] RSA 421-B:2.

It is important to point out that the definition of a security in the act includes a long laundry list of items.[125] The statute then identifies a few expressly excluded items that are not securities under the act. These express exclusions are for insurance and endowment policies or annuity contracts provided by an insurance company, membership in applicable LLCs and interests in qualifying partnerships.[126] Finally, the act also contains an extensive list of "exempt" securities, which are exempt from registration requirements but still subject to the anti-fraud provisions of the act.[127] The burden of proving that an instrument is not a security, or is an exempt security, rests with the party claiming the exclusion or the exemption.[128]

The expert retained by the Office of Attorney General, Attorney Krebs, points out that "[c]ontext is critical. The securities laws, state and federal, try to strike a balance between regulation that protects investors and a desire not to inhibit legitimate, ordinary course commercial transactions."[129] He recommends that the state expressly adopt the "Family Resemblance Test" as articulated in the *Reves* decision, the leading US Supreme Court case on determining whether a note is a security. [130] He argues that this would provide the BSR with the needed flexibility in determining what is a security subject to the Act. This standard would strike the appropriate balance between treating promissory notes as securities when they are not ordinary course of business transactions without having a non-flexible, bright line test that also ensnares ordinary course of business types of transactions that no one would deem a security or want to regulate as a security.[131]

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[125] See RSA 421-B:2 XX(a): "Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit sharing agreement; membership interest in a limited liability company; partnership interest in a registered limited liability partnership; partnership interest in a limited partnership; collateral trust certificate; pre-organization certificate or subscription; transferable shares; investment contract; investment metal contract or investment gem contract; voting trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas or mining right, title or lease or in payments out of production under such a right, title or lease; or, in general, any interest or instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

[126] See RSA 421-B:2 XX (a) and (b).

[127] See 421-B:17; the exemption for notes coupled with whole mortgages, discussed above, is one.

[128] See RSA 421-B:11 (I-b) (c) and RSA 421-B:17 (v).

[129] Testimony of Attorney Krebs, June 21, 2010 Hrg. Transcript at p. 5.

[130] *Reves v. Ernst & Young*, 494 US 56 (1990). Note, that the *Reves* case involved the interpretation of what is a security under federal law and is not directly applicable to the interpretation of the state law, unless the state legislature or the state courts apply it to the state law. To date, the *Reves* standard has not been explicitly adopted in New Hampshire in statute or applied by the courts.

[131] Id.

Furthermore, applying the Reeves family resemblance test would, he claims, bring NH in line with the treatment of Securities under federal law and most other states.[132]

On behalf of the Bureau of Securities, Professor Long in his expert opinion also relies on and seems to advocate for the use of the contextual analysis approach as adopted in the *Reves* case. [133]

The *Reves* Test:

Under the *Reves* test, the analysis of whether a promissory note is a security begins with a presumption that every note is a security. The presumption can be rebutted, however, only if the note in question bears a strong resemblance to one of the (judicially) enumerated categories of instruments which are deemed not to be securities:

(1) notes delivered in consumer financing;

(2) notes secured by a home mortgage;

(3) short term notes secured by a lien on a small business or some of its assets;

(4) a note evidencing a character loan to a bank customer;

(5) short-term notes secured by an assignment of accounts

receivable;

(6) a note which simply formalizes an open account debt incurred in the ordinary course of business; or

(7) notes evidencing loans by commercial banks for current operations.[134]

[132] By aligning our contextual analysis with the existing national standard, we could utilize the wealth of case law from around the country that applies that standard.

[133] See Professor Long Expert Opinion, dated April 21, 2010, p. 4. Note, however, that in testimony, Professor Long claims that the family resemblance test is meant only to add to the list of "non-securities," notes that resemble the enumerated non-securities. He claims that the AG's office in its report misapplied the test to deem certain instruments securities because they resemble other instruments that are known securities. See Professor Long Testimony, May 14, 2010, P. 92-94. However, as emphasized in the Nutter memo, the ***Reves*** test starts with a rebuttable presumption that an instrument is a security unless it bears a strong resemblance one of the enumerated non-securities. See Nutter Memo, May 12, 2010 Hrg. Transcript, p. 8. Professor Long's criticism appears to be a distinction without a difference. To the degree that an instrument bears a strong resemblance to another security, it would weigh against the existence of a resemblance to the enumerated non-securities and thus, the presumption that it is a security would not be rebutted.

[134] Attorney General Report, May 12, 2010, Appendix B, citing *Reves* 494 U.S. 56, at 65 (1990).

The *Reves* test utilizes four factors in determining if a note bears a strong resemblance to one of the above-listed enumerated notes:

A) Examine the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit, the note is expected to generate, the instrument is likely to be a "security." If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash flow difficulties, or to advance some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a "security.

B) Examine the "plan of distribution" of the instrument to determine whether it is an instrument in which there is "common trading for speculation or investment."

C) Examine the reasonable expectations of the investing public, and

D) Examine whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary. [135]

Applying these four factors in determining whether a "family resemblance" exists establishes that the "application of the term 'security' turns not on the form or characterization of the transaction but on the economic realities underlying the transaction."[136]

4. Ability to review possible securities to determine jurisdictional authority

***Recommendation 4:***

***While the current law appears to provide the BSR with the necessary powers, the Legislature should clarify that the BSR has sufficient authority to investigate transactions that may be securities to determine whether they are subject to the Securities Act and the power to examine entities that are required to be licensed under***

[135] Id.
[136] Attorney General Report, May 12, 2010, Appendix B. page. 3, citing *Idaho v. Gertsch*, 49 P.3d 392 (2002).

***the act. The Legislature should make it clear that similar authority exists for other regulators as well.***[137]

In a world which uses increasingly complex instruments, the contextual analysis recommended above will assist the regulators to respond to the evolving securities environment. The increased use of complex and rapidly evolving investment opportunities and instruments necessitates that the Bureau of Security Regulation have access to the information necessary to analyze these evolving offerings. However, traditionally a regulator's authority derives from the existence of the regulated activity. Thus, it is critical that the BSR have the explicit authority to review possible securities to determine whether they are subject to the act.

A regulatory agency needs investigative authority to determine whether the regulatory framework applies to a particular instrument and whether violations are occurring. This is particularly the case in the context of the Bureau of Securities Regulation where there are many securities which are exempt from registration but still subject to the anti-fraud provisions of the law.[138] If the regulator only has authority to investigate the registered securities, while the non-registered securities are technically subject to the anti-fraud provisions of the act, the regulator is significantly limited in being able to protect investors from fraud involving the unregistered securities.

It appears that this was one of the weaknesses that impacted the FRM matter. Former BSR Director Mark Connolly testified before the committee that he believed that the BSR did not have the authority to audit or investigate entities that were not licensed with the Bureau:

> The Bureau had no more authority to conduct an examination of FRM than we do of any other business that is not licensed with us. Despite this, could we have engaged in examination of FRM? Yes. We could have performed an exam provided we had the consent of the company and we did seek such consent and performed an exam. We do not have the independent right to go kicking down doors of any business we choose and start demanding records simply out of regulatory curiosity.[139]

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[137] RSA 397-A: 12 does provide the Banking Department with the authority to examine an entity who is not licensed to be a mortgage broker or banker in order to discover violations of the applicable laws.
[138] See RSA 421-B:17, which includes a list of over two dozen exempt securities, including the non-issuer sale of a note couple with a whole mortgage that was relevant to the FRM matter.
[139] Testimony of Mark Connolly, May 14, 2010 Hrg. Transcript, p. 7. The Committee does not necessarily agree with Mr. Connolly that the power to investigate should be equated with the right to "kick down doors."

The Department of Justice (DOJ), however, believes that prior to 2007 while the BSR did not have the authority to audit entities that were not licensed with them, they had extensive investigative powers, including the right to compel records and witness testimony, in order to determine if violations of the Security act had occurred.[140] Furthermore, the DOJ concludes that: "The Securities Act was amended in 2007 to authorize the Securities Bureau to audit those "licensed or required to be licensed under [the Securities Act]."[141]

To determine whether any violation of the security act has occurred or is about to occur, RSA 421-B: 22 provides the Secretary of State with broad powers to conduct public or private investigations. These powers include the authority to:

(a) Require any person to file a statement in writing, under oath, as to all the facts and circumstances concerning the matter being investigated;

(b) Hold hearings, upon reasonable notice, in respect to any matter arising out of the administration of the securities act;

(c) Conduct investigations and hold hearings for the purpose of compiling information with a view to recommending changes in the law to the legislature; and

(d) Require an issuer, broker-dealer, or agent to report all transactions as they pertain to any security.

A mechanism that permits the BSR to exercise its regulatory curiosity when there may be inappropriate behavior is necessary. In fact, one of the conclusions of the Attorney General's report into the FRM matter was that state agencies failed to exercise regulatory curiosity.[142] It is imperative that appropriate and clear statutory authority exist so that the BSR and other regulators understand that they have the power to exercise appropriate levels of regulatory curiosity via investigations and/or examinations, especially in an environment where many "securities" under the law are subject to the anti-fraud provisions of the law but exempt from registration.

[140] Testimony of Richard Head, May 21, 2010 Hrg. Transcript p.23; Attorney General Report, pp. 23-24.
[141] Id. See also HB 889 (Ch 104), Laws of 2007, effective July 1, 2007, which provided the BSR the right to audit entities that were not licensed but were required to be licensed under the Securities Act.
[142] Report of the Attorney General to the Governor and Executive Council on Financial Resources Mortgage, Inc., May 12, 2010, page 1, 5, 23, 26.

## VIII. The Office of the Attorney General

### A. Overview of the Office of the Attorney General's Actions and Testimony Regarding contacts with FRM

Three Bureaus within the Office of the Attorney General either had some oversight responsibility or a connection to the FRM matter. The Consumer Protection Bureau received complaints about FRM. The Civil Bureau received requests for legal assistance from the Bureau of Securities Regulation, and the Criminal Bureau received notice of potential criminal conduct engaged in by FRM.

It should be noted at the outset that in his report and in his testimony, General Delaney acknowledged that the Office "made serious mistakes in handling the FRM matter" and "missed opportunities to expose fraud."[143]

#### 1. The Consumer Protection Bureau

Pursuant to RSA 358-A, the New Hampshire Consumer Protection Act, the Consumer Protection Bureau ("CPB") is empowered to "investigate and prosecute unfair or deceptive acts or practices in the conduct of any trade or commerce within the State."[144] The role of the Bureau ordinarily is to "protect consumers from unfair or deceptive trade practices in New Hampshire. When a business does not provide services or products, misrepresents its services or products, or does not provide quality services or products, the Consumer Protection and Antitrust Bureau may question the business practices and seek appropriate measures to remedy the situation on behalf of the State of New Hampshire."[145] The CPB also derives its Authority from RSA 21-M:9.

In 2002, following a series of decisions issued by the New Hampshire Supreme Court, the law was amended to provide a broad exemption from coverage under the Consumer Protection Act to "trade or commerce regulated by the Banking Department, Securities Bureau, Insurance Department or the Public Utilities Commission."[146]

Between 2003 and 2008, the Consumer Protection Bureau received five (5) complaints that were directly related to FRM. Due to the fact that the complaints appeared to involve trade or commerce regulated by the Banking Department, they were

[143] May 21, 2010 Hrg. Transcript at p. 4.
[144] Attorney General Report at p. 44.
[145] NH Attorney General Consumer Protection Bureau website.
[146] Attorney General Report at p. 44, citing RSA 358-A3.

forwarded to Banking to handle. According to the Attorney General, the referral of the complaints were handled very much as an administrative manner.[147]

General Delaney noted that the complaints were serious. One complaint, received from a former employee of FRM, complained of predatory lending practices and provided a "tip that the company was improperly disposing of sensitive financial information in the dumpsters behind the building."[148]

According to General Delaney once these complaints were referred to the Banking Department, the Department of Justice did not have a mechanism to follow up on the complaint."[149] The lack of follow up was attributed to the fact that the Attorney General's Office did not have jurisdiction under the Consumer Protection Act if the matter fell within the jurisdiction of the Banking Department.[150]

General Delaney acknowledged that:

> I think it's clear that we need at the Department of Justice a system in place where if various things are going to be exempted from the Consumer Protection Act that there is going to be a mechanism for direction communication with the agencies to determine who has asserted jurisdiction and who will assume primary oversight in responding to the complaint and making a determination. That's something that did not work well between 2003 and 2008 . . . and we are working to develop a better referral system to fix that problem going forward.[151]

2. The Criminal Bureau

The Criminal Bureau of the Attorney General's Office exercises general supervision over all the criminal functions in the State.[152] In October 2005, the Criminal Bureau received a call from a citizen who believed FRM was engaging in criminal activity. He described what he believed to be a potential diversion of assets between Scott Farah's father's church and FRM.[153] He indicated that he was represented by Chris Carter, an attorney who had previously served as a prosecutor in the Attorney General's

[147] May 21, 2010 Hrg. Transcript at p. 5.
[148] Id.
[149] May 21, 2010 Hrg. Transcript at p. 6.
[150] Note however, that since commercial mortgages were not under the jurisdiction of the Banking Department, they likely should have remained under the Jurisdiction of the CPB. See Transcript May 21, 2010, pp 101- 103.
[151] May 21, 2010 Hrg. Transcript at p. 6.
[152] May 21, 2010 Hrg. Transcript at p. 6.
[153] May 21, 2010 Hrg. Transcript at p. 7-8.

Office. The investigator contacted Mr. Carter to discuss the complaint, who confirmed that there appeared to be criminal conduct. Although Mr. Carter said that he would send copies of court documents, the Office has no record of receiving them. Mr. Carter contacted the Criminal Bureau again in May of 2006 and spoke with the Chief Investigator.[154]

Following Mr. Carter's second contact with the Office, the Chief Investigator took the complaint to an attorney, and it went as far as the Bureau Chief for the Criminal Bureau. Based upon the description of the complaint, the Criminal Bureau Chief made a determination that the matter was beyond the scope of available staffing and resources. A further decision was made to refer the matter to federal authorities.[155]

General Delaney testified that in terms of the scope of its criminal jurisdiction, the Office handles prosecutions of homicides, public integrity and drug cases. It also writes briefs for all criminal appeals at the New Hampshire Supreme Court. [156] The Office handles some financial crime cases in which it is acting in a support role to County Attorneys, usually only at a threshold level of $100,000.[157]

It appears that, in the matter referred by Attorney Carter, the investigator involved raised the issue with the Federal Bureau of Investigation at their next regular meeting. However, there is no formal referral document and little if any documentation of the complaint. The Attorney General described the lack of such documentation as a failure of the Office.

3. The Civil Bureau

The third Bureau that had contact with FRM was the Civil Bureau. Attorneys in the Civil Bureau provide client counseling services and are litigators for State agencies.

The Secretary of State's Bureau of Securities Regulation sought advice of the Civil Bureau on three occasions in connection with FRM.[158] The communications are described in detail in the Attorney General's Report and will not be repeated here.[159] The first two contacts involved a full rescission offer to investors and freezing of assets to protect investors.[160] Although advice was given that the law at the time did not provide

[154] May 21, 2010 Hrg. Transcript at p. 8.
[155] Id.
[156] Id.
[157] May 21, 2010 Hrg. Transcript at p. 9.
[158] May 21, 2010 Hrg. Transcript at p. 10.
[159] Attorney General Report at pp. 50-51.
[160] May 21, 2010 Hrg. Transcript at pp. 11-12.

for asset freezing, no written response was provided to a letter sent the BSR inquiring about the issue.

General Delaney testified that he believed the Office failed in its client counseling responsibilities in that there should either have been a written follow up to the letter or documentation of what occurred.[161] No such documentation exists in the file.[162]

4. Communication between Bureaus within the Department of Justice

General Delaney explained to the committee that the lack of communication across Bureaus in the Attorney General's Office regarding the information they each had about FRM also constituted a failure of the Department of Justice.[163]

In 2006, the Consumer Protection Bureau fielded a complaint about FRM.[164] During the same year, an attorney in the Civil Bureau had a series of meetings with the Securities Bureau about freezing FRM's assets.[165] The Attorney General testified that it did not appear that the Criminal Bureau investigator had access to materials relating to the Office's client counseling responsibilities.[166] In addition, he described a later discovered fourth contact between the Environmental Bureau of his Office and the Banking Department relating to FRM. He noted that that this was "another example of information coming in with three agencies that had different pieces of the puzzle, and they didn't get put together."[167]

5. Sharing of Information Within and Among Agencies

Attorney Head testified about the effects of limited or no sharing of information between agencies, and also within individual bureaus of the agencies.[168] He noted that at:

> at the core of this case . . . there were various agencies and within agencies various bureaus that had knowledge and that knowledge . . . was isolated, and it was not being shared . . . And in this specific case, everybody had

[161] May 21, 2010 Hrg. Transcript at p. 12.
[162] Later in the summer, the law was changed and both Securities Regulation and the Attorney General's Office received authority to freeze assets
[163] May 21, 2010 Hrg. Transcript at p. 13.
[164] Attorney General Report at p. 49.
[165] May 21, 2010 Hrg. Transcript at pp. 13 -14.
[166] May 21, 2010 Hrg. Transcript at p. 14.
[167] May 21, 2010 Hrg. Transcript at p. 17.
[168] May 21, 2010 Hrg. Transcript at p. 46.

little bits of knowledge which if it had been accumulated and if it had been evaluated as a whole, a different result may have occurred.[169]

General Delaney also touched again on the issue of overlapping jurisdiction and communication. Among the recommendations made by the Attorney General's Office in connection with its review of the FRM matter were the creation of a regulatory working group and a centralized database in order to ensure sharing of information.[170]

6. Lack of Agency Resources

Representative Shaffer Hammond questioned the Attorney General about comments made during the hearing regarding lack of staff to conduct investigations or to undertake criminal matters. She noted the extensive use of volunteers to handle the 15,000 complaints received by the Consumer Bureau each year and asked, "Is this any way to run a state?" General Delaney replied that, "we live in a state where there is some level of disdain for regulation until you want regulation. And at some level you get what you pay for."[171]

7. Document Retention by the Attorney General's Office

Many questions were asked regarding the document retention policies of the Attorney General's Office and whether it was possible that so few documents were received and generated in connection with FRM by that Office. General Delaney noted that State archives mandates that State agencies maintain documents for four years. There were changes in document retention following amendments to the Right-to-Know law in 2008.[172] In response to questions by Senator Cilley, General Delaney noted that, to the best of his knowledge, the e-mail retention policy in effect at the time his predecessor, General Ayotte, left office was the policy followed when any attorney left office. E-mail accounts, inbox, outbox and deleted e-mails were deactivated through a process with the Office of Information Technology.

[169] Id.
[170] May 21, 2010 Hrg. Transcript at p. 48.
[171] May 21, 2010 Hrg. Transcript at p. 71.
[172] May 21, 2010 Hrg. Transcript at p. 77.

B. Attorney General's Review of the FRM Matter

1. Potential Conflict in Reviewing Its Own Involvement in FRM

On May 12, 2010 the Attorney General issued a detailed Report on the FRM matter, which was undertaken at the request of the Governor and Executive Council regarding the roles of the various State agencies responsible for oversight and regulation of FRM. [173] Attorney General Delaney was asked whether, due to his Office's involvement with the Securities Bureau in connection with the FRM matter, he felt he could appropriately conduct the review of agency action requested by the Governor and Council.[174] He stated that, "I fully recognize that, in part, I have issued a report that evaluates the conduct of my own agency."[175]

Prior to the Office of Attorney General commencing work on the requested review, General Delaney ordered that a preliminary assessment be undertaken in conjunction with the Secretary of State's Office to determine if a conflict existed that would prohibit the Office of Attorney General conducting the review. According to the AG's Report the preliminary assessment concluded that his "Office could conduct an impartial review." It should be noted however, that the preliminary joint conflicts analysis appears to have only considered the role of the Civil Bureau in regards to the 2003 request for assistance.[176]

The preliminary joint conflict review does not appear to have considered the operational failures of the Criminal Bureau or the involvement of the Consumer Protection Bureau with FRM. Of particular concern is the fact that the primary author of the report, Attorney Richard Head served as the Chief of the Consumer Protection Bureau from September 2004 to December 2007, and was Acting Bureau Chief of the Consumer Bureau for the calendar year 2009. This included a time period when two complaints were received by the CPB regarding FRM. The Attorney General Report does explain that Attorney Head was not personally involved in those complaints and that the Office believes they did not have jurisdiction over the FRM complaints. While the Committee is in no way suggesting that Mr. Head was anything but open and honest in drafting the report, the perception of a conflict appears to have undermined the credibility of the endeavor.

[173] The description of this testimony will be brief given that the full text of the Attorney General's report is available online.
[174] May 21, 2010 Hrg. Transcript at p. 33.
[175] May 21, 2010 Hrg. Transcript at p. 35.
[176] See AG Report Appendix A.

Even though the DOJ review may contain the appearance of a conflict, it is important to point out that General Delaney repeatedly acknowledged the serious mistakes that took place in the Department of Justice.[177]

2. Selection of the Nutter McClennen Firm

Representative Holder asked the Attorney General about the decision to bring in the Nutter McClennen law firm to assist in the case. General Delaney clarified that they had wanted to receive the assistance of a law firm "that specialized in both Securities and Banking laws, because those are areas that have been outside of our primary jurisdiction since 2002."[178] They also needed to retain a firm that did not have any matters pending before either agency. (There was extensive follow up discussion regarding the choice of Nutter McClennen and the firm's involvement in the Pennichuck Water Works matter at the June 21, 2010 hearing.)[179]

3. Characterizing Victims as "Lenders" or "Investors"

Represenative Keans expressed concern about the characterization in the AG Report of FRM's victims as investors. Senator Hassan explained to Attorney Head that, "[a] number of the members of the public whose savings have been devastated by the actions of FRM, and Scott Farah and Dodge and the like, raised the issue that they do not believe they were investors. They were lenders."[180] Based on that understanding, Senator Hassan asked Attorney Head to address: 1) whether there is a distinction in the facts here; and 2) what the significant of that distinction is; and 3) at some point, did lending and investing get somehow merged and by whom?[181]

Attorney Head responded that it "is a question of what were the representations by Farah and what was actually happening within the operation of FRM and CLM."[182] He expanded on the answer, stating that:

> They understood that when they gave just, for example, $100,00.00, that $100,000.00 was going to fund a particular project. So yes, they reasonably believed that they were lenders, they were lenders to a

[177] Id.
[178] May 21, 2010 Hrg. Transcript at p. 54.
[179] June 21, 2010 Hrg. Transcript at pp. 20-30.
[180] May 21, 2010 Hrg. Transcript at p. 29.
[181] Id.
[182] Id.

> particular project, and that they were going to receive income based upon payment on that particular project.
>
> As it actually operated, the money that . . . those people, the citizens who gave money to Farah, ultimately their money was being pooled. Their money was being used for the project, at times, that they thought they were investors that they were lending for. And it was used for other projects because . . . as the trust system proceeded, at times there would be a closing with a trust without a borrower, without a lender, without an investor . . ..[183]

Attorney Head was asked whether, had the Attorney General's Office thought that these individuals were lenders, it might have triggered a different response. Given that both the Securities Bureau and Banking Department fell within exemptions to the Consumer Protection Act, he responded it may just have impact how complaints were referred.[184]

## C. Office of the Attorney General - Management and Operational Functioning

Based upon its charge from the Governor and Executive Council, the Attorney General conducted a review and issued a report on the operation of state government as to its oversight and regulation of FRM. The Office evaluated its own management and operational functioning, as well as that of Banking and Securities Regulation. For the most part, the Attorney General's Office was extremely forthcoming in recognizing and identifying areas of operational failure and in providing suggestions for correction of such deficiencies. Thus, the majority of the failures listed in this Report are in agreement with those already identified in the Attorney General's report. The Committee though notes some additional issues:

**Finding 1: The Consumer Bureau automatically referred complaints that appeared to fall within Banking's jurisdiction without considering the issue of residual or alternative jurisdiction**

Based upon the testimony received at the hearings, it appeared that, in connection with the five (5) complaints regarding FRM received by the Attorney General's Office, there was an automatic referral to Banking based on the fact that the exemption appeared to apply. However, as the Attorney General and Attorney Head acknowledged, the

[183] May 21, 2010 Hrg. Transcript at p. 30. See also June 21, 2010 Hrg. Transcript at pp. 33-37, where Representative Palfrey asks additional questions regarding the nature of loans versus investments.
[184] May 21, 2010 Hrg. Transcript at p. 32.

complaints were serious. In at least in one case and possibly more, the complaint(s) had criminal overtones.

The Attorney General certainly had retained jurisdiction over criminal matters that might have formed a basis for asserting jurisdiction. Particularly in the case of the 2004 complaint, there were allegations by a former employee that FRM engaged in predatory lending practices, including mining closed files and encouraging clients to continually reuse their home equity. The complainant further alleged that FRM passed itself off as a lender rather than a broker to keep customers from realizing that they were paying too much for a loan that could be procured from another lender.[185]

Representative Butler noted that the complainant stated that she "hated lying to people so [she] left" FRM.[186] To the extent that there was some implication that there may have been criminal activity going on, he asked if the Attorney General's Office had investigated it. Attorney Head stated that the complaint had been referred to Banking, but acknowledged that a "stronger response" might have been reasonable.[187]

In addition to the residual jurisdiction, the Bureau may also have had jurisdiction under RSA 21-M and RSA 358-A over matters involving unfair and deceptive acts in connection with commercial lending, which was outside the scope of Banking's jurisdiction. This scope of jurisdiction was apparently not considered or used by the Attorney General's Office in connection with any of the complaints it received.

**Finding 2: The Criminal Bureau failed to exercise appropriately its jurisdiction regarding complaints of criminal activity or to effectively refer such matters to federal agencies with authority to pursue them**

The Criminal Bureau received contacts from an outside complainant and attorney providing notice that FRM was engaging in criminal activity. The first contact occurred in 2005 and involved an allegation that funds were being diverted from Mr. Farah's father's church to FRM, and then returned to the church.[188] In 2006, there was another contact with the Office and the allegations were confirmed by the attorney for the complainant, who was a former prosecutor in the Criminal Bureau. The matter was brought to the attention of the Criminal Bureau Chief who, according to a now retired

[185] Attorney General Report at p. 49. The other complaints received by the CPB also complained of predatory lending practices.
[186] May 21, 2010 Hrg. Transcript at p. 59.
[187] May 21, 2010 Hrg. Transcript at p. 60.
[188] Attorney General Report at p. 51.

investigator, concluded that the Bureau lacked adequate resources to investigate and prosecute the matter.[189]

After deciding that the Office would not pursue the matter, the investigator referred the matter to the FBI. There is no record of the referral. The Attorney General acknowledged in his testimony that "we do not believe the referral was made in an effective way."[190] He noted that, "it was done in an informal way and we made no documentation of follow-up that they were going to assume it. That's a problem, and that shouldn't occur and we need to fix that."[191]

It is also interesting that there apparently was no thought of referring the matter to the Bureau of Securities Regulation, which shared the ability to investigate such cases with the Attorney General's Office. This fact is additional evidence of a failure to consider alternative jurisdiction as described in Finding #1.

**Finding 3: The Civil Bureau failed to document adequately its communications with a client agency**

Mr. Spill testified regarding his communications with the Attorney General's Office with respect to freezing of assets of FRM in the summer of 2003. While he understood that the Attorney General did not intend to undertake this course of action, he did not receive a written response to his letter. The Attorney General's Office acknowledges that this was a failing which must be addressed in the future.

**Finding 4: Lack of Communication within the AGO hampered discovery of ongoing unlawful conduct by FRM**

Given the serious nature of matters that may be brought to the attention of the Criminal Bureau, it is important that the Office have some process for vetting the complaints, even if not conducting a full investigation. In this case, had the Criminal Bureau checked with the Civil Bureau (or the Office as a whole) at the time it received complaints regarding FRM's alleged criminal activity, it would have learned that the Securities Bureau had an ongoing enforcement matter pending with which the Civil Bureau had involvement.

[189] Attorney General Report at p. 52.
[190] May 21, 2010 Hrg. Transcript at p. 73.
[191] Id.

**Finding 5: The AGO failed to implement effective internal procedures to ensure that serious criminal and consumer protection matters were brought to the attention of the Attorney General**

The internal management procedures of any department ultimately is the responsibility of the head of that department. Thus, it is the responsibility of the Attorney General to implement effective internal practices to ensure that when the Department of Justice is made aware of an important criminal or consumer protection matters that information reaches his or her desk. The Attorney General must implement internal practices to ensure that he or she is briefed when a series of criminal and consumer complaints come to the office against a particular bad actor.

D. Statutory Reform regarding Office of Attorney General Authority

1. Consumer Protection Act

***Recommendation 1:***

***Eliminate ambiguity as to which practices and/or entities are covered by the Consumer Protection Act.***

***The Joint Committee recognizes that the consumer protection system that has been in place for the past several years has worked reasonably well in many matters and arenas other than the FRM situation. Yet the FRM matter highlights weakness within that system. The legislature needs to revisit the language for the regulatory exemption to the Consumer Protection Act to determine how to create more effective administrative or judicial consumer protections without creating undue costs and hardships on businesses that do not engage in unfair or deceptive practices. It should determine, again, whether the exemption should apply only to "expressly permitted activities," "functionally equivalent administrative protections against unfair and deceptive practices" or broadly to "all trade and commerce subject to regulatory oversight. Most importantly, the legislature needs to remove any ambiguity over the scope of the exemption.***

a) History:

The Consumer Protection Act (CPA), RSA 358-A, originally enacted in 1970, forbids "any unfair method of competition or any unfair or deceptive act or practice in the conduct of any trade or commerce within this state."[192] The CPA "is a comprehensive

[192] RSA 358-A:2.

statute whose language indicates that it should be given broad sweep, [but] it is not unlimited in scope."[193] The CPA has always included language exempting some regulated activities or regulated entities from the act.

Unfortunately, as evidenced in the FRM matter, under the existing statute there is some ambiguity over what regulated activities and/or entities are subject to the CPA, and what agency has authority to enforce the existing consumer protections when they involve industries that are regulated by other agencies under other statutes. In the FRM case, this ambiguity resulted in missed opportunities for enforcement that should have been provided through the consumer protections in the Banking and Securities regulations, as well as the CPA.

b) The exemption for regulated activities or regulated entities under the Consumer Protection Act.

The Consumer Protection Act gives aggrieved citizens the ability to file lawsuits to seek remedies for "unfair and deceptive trade practices" to which they are subjected.[194] The Act also authorizes the Consumer Protection Bureau of the Department of Justice to investigate alleged "unfair and deceptive trade practices" and to take enforcement action against violators by bringing lawsuits in the name of the state to prevent such behavior and to seek restitution for injured consumers.[195]

In addition to the CPA, the state regulates numerous industries and professions in order to protect the public. These industries include banking, insurance, public utilities, and the sale of securities, while the regulated professions include lawyers, doctors, nurses, plumbers and electricians. A 2001 legislative study committee report found that at that time there were over 80 professions regulated in the state by a board or agency.[196]

From its inception, the Consumer Protection Act has contained exemptions from the act for some regulated entities or activities. The rationale behind the exemptions is that since certain businesses or activities are already regulated in order to protect the public, they need not also be subject to the Consumer Protection Act. The State of New Hampshire has struggled with determining the scope and applicability of this exemption since 1986. The legislature needs to decide how the exemption should function in the future.

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[193] Averill v. Cox, 145 N.H. 328, 331 (2000) quoting Hughes v. DiSalvo, 143 N.H. 576, 578 (1999).
[194] RSA 358-A:10.
[195] RSA 358-A:4, III.
[196] See HB 109, Chapter 12:1 (2001) Study Committee.

Prior to 2002, RSA 358-A:3 (I) provided an exemption under the Consumer Protection Act for:

"[t]rade or commerce otherwise permitted under laws as administered by any regulatory board or officer acting under statutory authority of this state or of the United States."

As explained below, from 1986 through 2000, the NH Supreme Court articulated at least two competing interpretations of this exemption. From 2000 to 2004, the Legislature likewise struggled to decide between varying competing public policy choices regarding what exemption should apply.

**Judicial Interpretation of the Regulated Industries Exemption**:

In 1986, in the *Rousseau I* case, the New Hampshire Supreme Court interpreted the RSA 358-A:3 (I) exemption very expansively as applying to trade or commerce that is subject to a regulatory board or officer authorized by statute.[197] The Court suggested that not only attorneys, but physicians, plumbers and electricians would all be exempt from the CPA because they are subject to a regulatory board.[198] In this case, the court appeared to apply the exemption to any entity subject to regulation by a board or agency.[199]

However, in 1992 the Supreme Court in *Gilmore* rejected the *Rousseau I* interpretation and instead adopted a very narrow exemption which applied only to acts or

[197] *Averill v. Cox*, 145 N.H. 328, 331 (2000) discussing *Rousseau v. Eshleman*, 128 N.H. 564, 567 (1986) (R*ousseau I*),.

[198] The Court stated that: "The consumer protection act contains no language expressly exempting law, medicine or other learned professions from its reach. However, the act exempts "[t]rade or commerce otherwise permitted under laws as administered by any regulatory board or officer acting under statutory authority of this state or of the United States." RSA 358-A:3, I. Presumably, physicians would be considered exempt from the act because they are subject to licensing and regulation by a board of registration under RSA 329:2 (1984, Supp.1985, Laws 1986, 219:1). The same would be true of electricians, RSA 319-C:4 (1984 and Supp.1985), and plumbers, RSA 329-A:3 (1984 and Supp.1985). We must decide whether under RSA 358-A:3 attorneys enjoy a similar exemption from the provisions of the act or whether the legislature intended that they be subject to the act." R*ousseau I* at 567.

[199] After a change in the membership of the court, the court denied a rehearing of the case but the new justice wrote a concurring opinion indicating that attorneys were not exempt from the consumer protection act because their regulation by the Supreme Court was authorized by constitution rather than by statute (a requirement for the exemption). However, the new justice agreed that the CPA did not apply to the case being litigated because in his opinion, the claims raised by the plaintiffs did not involve the trade or commerce aspects of lawyering but the practice of law itself which was beyond the scope of the act. See *Rousseau v. Eshleman* 129 N.H. 306 (1987) (*Rousseau II*).

transactions which were expressly permitted under New Hampshire or federal regulatory statutes themselves or permitted by a regulatory board or officer under a statute.[200]

An alternative approach to either the overly expansive application in the 1986 *Rousseau I* case or the extremely narrow approach in the 1992 *Gilmore* majority opinion was provided by Justice Horton in his minority concurrence in the *Gilmore* case. He argued that the analysis as to whether the exemption applies should be based on whether the regulatory framework to which the entity is subject is functionally equivalent to the consumer protections available under the consumer protection act. In his opinion, he endorsed an approach whereby the exemption applies to all transactions arising under regulated trade or commerce if the administrative regulation provides functionally equivalent substantive protection and an appropriate dispute resolution procedure for consumers.[201]

In 2000, the New Hampshire Supreme Court in the *Averill* decision revisited the issue and decided to reject the narrow exemption available only for acts or practices that are expressly permitted.[202] Instead it returned to an exemption of all trade and commerce subject to comprehensive regulation.[203] However, this time, the Court relied heavily on the Horton concurrence's functional analysis approach. Thus it held that:

> Trade or commerce qualifies for the protection only if it is governed by a statutorily authorized regulatory regime that protects consumers from the same deception, fraud, and unfair trade practices as intended by RSA chapter 358-A. … The statutory exemption to the Act, however, does not require that remedies available to aggrieved consumers under qualifying regulatory schemes be *identical* to those provided in the Act. Rather, it is sufficient that the regulatory scheme protects consumers from fraud and deception in the marketplace " *in a*

[200] *Gilmore v. Bradgate Assocs., Inc.*, 135 N.H. 234 (1992). In *Gilmore*, the court determined that the regulation of condominiums by the state did not exempt the sale of condos from the CPA.

[201] Justice Horton argues that the expressly permitted activity standard does not make sense as any activity that is expressly permitted could not be an unfair and deceptive practice anyway, so why exempt it. Thus, he believes the exemption must apply to all trade and commerce as long as the regulatory structure to which the entity is subject is functionally equivalent to that provided by the CPA. In other words, he feels the legislature can decide to provide administratively what would otherwise have been available judicially through the CPA. In the end, he agrees with the majority holding in the *Gilmore* case because in his opinion, the statutory regulation of condominiums is not functionally equivalent to the CPA in that there is no administrative remedy for injured consumers to pursue. Id.

[202] *Averill v. Cox*, 145 N.H. 328 (2000).

[203] In the end, the *Averill* decision reaffirmed that attorneys are exempt from the Consumer Protection Act.

> *manner calculated to avoid the same ills* as RSA chapter 358-A."[204]

**The Legislative History Amending the Regulated Industries Exemption**

In 2002, in response to the Supreme Court's 2000 *Averill* opinion, the battle over the scope of the regulated entity exemption shifted to the legislature. In part, the focus of the legislature on this issue derived from a 2001 legislative study committee report on the status of consumer protection in the state.[205]

The study committee found that there was "statistical evidence of a rising tide of complaints by consumers of abuse, fraud and misrepresentation."[206] Among other things the committee recommended that the legislature increase resources for consumer protection, improve coordination and communication between the varying regulatory departments and conduct a careful review and analysis of the scope and breadth of the "regulated industries" exemption.[207] HB 1429 (2002) was the legislative response to this last recommendation.

House Bill 1429 (2002), as originally introduced and as passed by the House, would have excluded trade or commerce from the consumer protection act only if it was *expressly or specifically permitted* under laws, rules, standards or regulations of regulators who were charged with comprehensively regulating the trade or commerce. If not expressly authorized, the Attorney General would have the authority to investigate and prosecute violations of the Act, and consumers would have been free to pursue restitution.[208] In essence, this approach would have returned the exemption to the narrowest, "expressly permitted activity" approach.

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[204] *Averill at 333-334* (Citations Omitted).

[205] HB 109, Chapter 12:1 (2001) charged the study committee with assessing "the scope of need for consumer protection within New Hampshire; the ability of the attorney general's consumer protection bureau to meet this need; and any appropriate changes in funding, staffing, and/or agency structure that would better protect the state's consumers."

[206] See HB 109, Chapter 12:1 (2001) Study Committee.

[207] See Exhibit 24 of the Report of the Attorney General to the Governor and Executive Council on Financial Resources Mortgage, Inc., May 12, 2010.

[208] The House passed version of HB 1429 (2002) added a definition of a "regulated person" and provided for exemption only for specifically permitted acts or practices as follows:

> I-a. "Regulated person" is any person, who is subject to laws, regulations, or standards that regulate unfair or deceptive acts or practices in the conduct of trade or commerce and who is regularly examined for compliance with such laws, regulations, or standards by a federal or state regulatory authority or is subject to sanctions or remedial action by said authority for failure to comply with such laws, regulations, or standards, such as banking, insurance, or a utility company.

In 2002, the Attorney General's office advocated for adoption of this more limited exemption to the Consumer Protection Act where only acts or practices which were specifically permitted under a regulatory framework would be exempt. General Delaney testified that the Attorney General's Office fought "tooth and nail" when the exemptions to the Consumer Protection Act were modified in 2002 because "we did not believe that there should be a wholesale exemption of jurisdiction in the areas of Banking and Securities from the Consumer Protection Act . . . we felt that consumers should have a private right of action and a seat at the table relative to unfair and deceptive practices."[209] He stated that there has been struggle on the part of all three agencies in dealing with issues of jurisdiction, and that this was an area in which "the General Court can add some tremendous value in revisiting that legislative history in trying to help us find ways to make sure that those three jurisdictional hooks are working in the best interests of investors and borrowers in the state." [210]

However, on the floor of the Senate, the bill was amended to add an exemption for any trade or commerce by a person who is subject to federal or state comprehensive regulation of unfair or deceptive acts or practices.[211] The originally passed Senate (and

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Consumer Protection; Exempt Transactions; Regulated Persons. RSA 358-A:3, I is repealed and reenacted to read as follows:
I. Any act or practice in the conduct of trade or commerce by a regulated person that is specifically permitted by laws, regulations, or standards to which it is subject. Any regulated person engaging in any act or practice in the conduct or trade or commerce which is not exempt under this paragraph shall be subject to RSA 358-A only to the extent as follows:
(a) The attorney general may take enforcement action to remedy any such act or practice in violation of RSA 358-A pursuant to RSA 358-A:4, III and III-a, RSA 358-A:5, RSA 358-A:7, and RSA 358-A:8.
(b) Any individual injured by any such act or practice in violation of RSA 358-A may bring action for damages and for such equitable relief, including an injunction, as the court deems necessary and proper, against a regulated person. A prevailing plaintiff shall be awarded reasonable attorneys' fees and costs, as determined by the court. If the court finds that the plaintiff's actions were frivolous, the court shall give reasons thereof in writing and may assess reasonable attorneys' fees and costs.

[209] May 21, 2010 Hrg. Transcript at p. 44.
[210] Id.
[211] The senate amended language provided an exemption for "trade or commerce by any person who is subject to laws, regulations, standards, orders, or other action of a federal or state regulatory authority that regulates unfair or deceptive acts or practices in the conduct of such trade or commerce, and who is regularly examined for compliance with such laws, regulations, standards, orders, or other action by a federal or state regulatory authority or is subject to sanctions or remedial action by such authority, including without limitation restitution, reparation, or damages which may be ordered by such authority or may otherwise be available to the injured person by statute or regulation, for failure to comply with such

House) version required that for the exemption to apply the scope of regulatory authority would have to include substantial regulatory oversight powers and/or procedures for aggrieved consumers to obtain remedies.[212] Thus, this version included aspects of the functionally equivalent approach to the exemption.

Because the Senate language differed from the House language, HB 1429 was sent to a Committee of Conference. The Committee of Conference[213] amended the bill to its final form that exempts from the CPA:

> Trade or commerce that is subject to the jurisdiction of the bank commissioner, the director of securities regulation, the insurance commissioner, the public utilities commission, the financial institutions and insurance regulators of other states, or federal banking or securities regulators who possess the authority to regulate unfair or deceptive trade practices. [214]

The final version adopted through the committee of conference had the most expansive exemption in that it exempted all trade or commerce subject to the regulation of the identified regulators without regard to whether the activity was expressly permitted (as contained in the originally passed House version) or whether the extent of regulation provided a comprehensive regulatory process or a possible avenue for a remedy for an aggrieved consumer (as contained in the originally passed Senate and House versions).

## The Legislative Options for Reforming the Exemption

In considering how to reform the regulated industries exemption, the legislature needs to keep in mind the positives and negatives as well as the impact of each choice.

i) **"Expressly permitted activities[215]"** provides the greatest protections for consumers. Unless an activity is expressly authorized by statute (or possibly regulation) an aggrieved consumer could bring a consumer protection complaint against the regulated entity. This standard provides the maximum jurisdiction under the act as well as the most

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laws, regulations, standards, orders, or other action, such as a banking, insurance. or utility company." (emphasis added)

[212] See previous footnote.

[213] The conference committee consisted of Representatives Hunt, L Fraser, Batchelder & Dyer, and Senators Prescott, Flanders, & D'Allesandro.

[214] A 2004 Amendment (SB207), Chapter 141 Laws of 2004, added an additional provision exempting retail installment sales of motor vehicles subject to Banking Department regulation. The new provision provides: "This paragraph includes trade or commerce under the jurisdiction of, and regulated by, the bank commissioner pursuant to RSA 361-A, relative to retail installment sales of motor vehicles."

[215] See *Gilmore* majority opinion and original House Passed HB 1429 (2002) for examples of this standard.

consumer protections. However, some argue that this standard could subject businesses to many more consumer challenges. As the consumer protection act places the burden of proof of the exemption on the party claiming the exemption, this standard could force business to prove in court that the relevant business activity is expressly authorized by law. This may be a difficult task, as some common business activities may not be expressly permitted (for example, it has been argued that the rental of safety deposit boxes are not expressly authorized by law). However, if an activity were not exempt as being specifically permitted, the plaintiff would still need to prove the existence of an unfair and deceptive practice. Businesses may be concerned that the possibility of treble damages and an award of attorney fees could spur a rash of frivolous suits that they would be forced to defend. To counter this concern, the original House-passed version of HB 1429 (2002) which incorporated the "expressly permitted" standard, empowered the judge to award attorney fees and costs to the defendant if the case was frivolous.

ii) **"Functionally equivalent administrative protections against unfair and deceptive practices"[216]** - This standard reflects a rational elegance. If certain trade and commerce are exempted from the CPA, then it makes sense that functionally equivalent protections exist. Likewise, if functionally equivalent protections exist, why subject businesses to duplicate statutory systems? The difficulty with this elegant standard is in the details of its application. What constitutes functional equivalence? If an entity is subject to annual audits/examinations and the potential administrative loss of license for non-compliance or questionable practices, is that functionally equivalent to the private right of action available to aggrieved parties under the CPA? Is a consumer-initiated grievance process a requirement to establish functional equivalence? Additionally, this standard is meant to apply to all trade or commerce subject to the functionally equivalent regulation. However, in the increasingly complex world of commerce, some of an entity's activities may fall within the scope of the functional equivalent regulated framework and some may not. Who determines which are covered and which are exempt? If the legislature endorses this approach it will need to define the details of both the scope of exemption and the standard for functional equivalence.

[216] See the *Rousseau* I case as an example.

iii) **"All trade and commerce subject to regulatory oversight"** This is the most expansive of the exemptions. It provides the least consumer protections but is arguably the least onerous to business. This standard eliminates any need to determine whether the regulatory structure is functionally equivalent to the protections in the CPA. If it is a regulated activity, it is exempt. This approach has numerous drawbacks. Many aspects of trade or commerce are regulated but without robust focus on consumer protections. A 2001 legislative study committee report found that at that time there were over 80 professions regulated in the state by a board or agency. Under this standard all of those professions or industries could be exempt from the consumer protection act. If the legislature chose to proceed with this standard it would still need to address the issue of determining the scope of the exemption when an entity is regulated but engages in other possibly unregulated activities.

c) Enforcement of the Consumer Protection Act

***Recommendation 2:***

***It is critical that the Legislature clarify what agency or multiple agencies have the exclusive or co-extensive authority to enforce and administer the Consumer Protection Act, and/or other consumer protections, especially in circumstances where regulated entities are involved. It is recommended that the exclusive enforcement authority that had been provided to Banking and Securities be deleted. Instead, coextensive authority for enforcement should be provided to the Department of Justice. However, where coextensive authority exists, the statute must identify one agency as having supervisory authority with ultimate responsibility to ensure cases do not fall through the cracks.***

The law provides that the provisions of the Consumer Protection Act "shall be administered and enforced by the consumer protection and antitrust bureau of the Department of Justice." RSA 358-A:4.[217]

It is important to point out that even though the Consumer Protection Bureau is statutorily tasked with administering and enforcing the consumer protection act, the act provides any injured person the right to bring a private action to enforce violations of the act. See RSA 358-A:10.

[217] The Consumer Protection Bureaus of the Department of Justice's responsibility for administering and enforcing the CPA is also referenced in RSA 21-M:9 II (h).

However, the exemptions from the act for certain regulated entities and/or regulated activities (discussed above) has removed the Attorney General's authority for consumer protection in these areas. By exempting certain regulated entities or activities from the consumer protection act, you not only eliminate the Attorney General's enforcement role, but you also eliminate the private citizens' right to file suit to stop a violation of the CPA that harms them. The regulatory exemptions to the CPA take the power and control away from the consumer and require that the consumer rely entirely upon the regulator in order to obtain restitution. In an environment of limited agency resources, this could effectively limit the remedies available to consumers harmed by unfair and deceptive practices of a regulated entity. Conversely exempted agencies which are self-funded, or which have a significant focus on consumer protections, can resolve consumer complaints satisfactorily and more quickly than the judicial route.

In 2004, the Legislature passed a law which attempted to ensure that regulators had the ability to order restitution but at the same time the law made it clear that the regulator had the exclusive authority to investigate and enforce unfair and deceptive practices by the regulated entities.

The Banking Department was provided this exclusive authority in 2004, when RSA 383:10-d was amended to provide the banking commissioner with the "exclusive authority and jurisdiction to investigate conduct that is or may be an unfair or deceptive act or practice under RSA 358-A and exempt under RSA 358-A:3, I." [218] It also empowers the commissioner to hold hearings and order restitution for aggrieved consumers. While the commissioner is given exclusive authority to investigate these unfair and deceptive practices, it allows, but does not require, the Bank Commissioner to "request the assistance and services of the consumer protection and antitrust bureau of the department of justice" in fulfilling this duty. Furthermore, the law requires the Bank Commissioner to refer alleged criminal activity to the Attorney General for investigation and prosecution of the criminal act. [219]

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[218] That law also provides the Bank Commissioner with the exclusive authority to investigate conduct that may violate any of the provisions of RSA Title 35, relative to Banks and Banking; Loan Associations; Credit Unions, consisting of RSA 383 to 397-B, and RSA Title 36, relative to pawnbrokers and moneylenders consisting of RSA 398 to 399-F as well as administrative rules adopted there under.

[219] The Banking Commissioner was provided the exclusive authority to enforce the CPA regarding regulated entities in his jurisdiction together with the power to order restitution in 2004 as part of HB 1282, Chapter 210 (2004). It is instructive to read the House Calendar blurb related to this bill in that it highlights the difficult balance that was being attempted between establishing access to restitution for aggrieved consumers without subjecting businesses to multiple oversight:

> HB 1282, relative to exemptions from the consumer protection act. OUGHT TO PASS WITH AMENDMENT

Prior to the 2004 amendment, RSA 383:10-d did not provide the commissioner of banking with the power to order restitution. It also did not explicitly provide the commissioner with the exclusive authority to investigate consumer complaints.

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Rep. Leo W. Fraser, Jr. for Commerce: This legislation, as amended, will have far reaching effects on the ability of consumers to receive restitution in the event the consumer has been harmed by unfair or deceptive acts or practices of a regulated or licensed financial entity or an insurance company. Essentially the bill gives the relevant regulatory agencies the exclusive authority and jurisdiction to investigate conduct that is or may be an unfair or deceptive act or practice, yet is exempt from the Consumer Protection Act under RSA 358-A:3, I. The bill, as introduced, would have added the real estate commission to the list of exempt departments under the consumer protection act. Currently any "Trade or commerce that is subject to the jurisdiction of the bank commissioner, the director of securities regulation, the insurance commissioner, the public utilities commission, the financial institutions and insurance regulators of other states, or federal banking or securities regulators who possess the authority to regulate unfair or deceptive trade practices" is exempt from the consumer protection act. The bill now gives authority and jurisdiction to the bank commissioner to investigate conduct by all regulated financial entities and licensees, including pay day lenders and title loan companies, that may be an unfair or deceptive act or practice. The insurance commission already has such authority and jurisdiction with respect to regulated entities and persons subject to its jurisdiction. The legislative intent is that any business that is exempt from RSA 358-A may be ordered by its regulatory agency to pay restitution to any consumers that the business may have harmed by committing unfair or deceptive acts. During the subcommittee work session, the Attorney General's Office of Consumer Protection emphasized that the customers injured by unfair or deceptive acts of the exempted regulated industries should have access to the remedies that are established by RSA 358-A. While RSA 358-A does provides a method for such restitution, the committee did not want to subject highly regulated industries to dual supervision, because it would be inefficient for the state and unfair to the regulated industry. However, the committee feels strongly that consumers should be able to obtain restitution. As a result of that discussion, the subcommittee then reviewed whether restitution was available under the four exemptions. Only two did not have restitution, banking and insurance. Currently, New Hampshire Insurance and Banking Department may suspend, revoke or refuse to renew the license of any person found to have violated their statutes. The insurance department does currently have an unfair trade practice statute but banking does not. Under the amendment to HB 1282, the insurance commissioner may order payment of restitution for actual economic loss sustained by any individual directly injured by violation of RSA 417, the insurance unfair trade practice law. Since banking did not have an unfair trade practice statute, the bank commissioner under this legislation, will be authorized to enforce the provisions of RSA 358-A against its regulated community. The bank commissioner will now be able to order restitution to consumers, who have not only been harmed by any violation of current banking laws or regulations, but also any unfair or deceptive acts or practices as defined by RSA 358-A. The committee feels this is a reasonable compromise and is intended to insure that consumers have a way to gain redress with minimal cost and effort. The committee would also make it clear that consumers do not have the right to take legal action under 358-A against those who are exempted under 358-A. The consumers will now be able to efficiently obtain redress of any unfair trade practice through restitution from the state departments that regulate those exempt businesses. **Vote 16-0. House Record #19, March 12, 2004.**

The Bureau of Securities Regulation in the Secretary of State's Office likewise was provided the "exclusive authority and jurisdiction" "to investigate conduct that would be an unfair or deceptive act or practice under RSA 358-A and that is subject to the jurisdiction of the director of securities regulation pursuant to RSA 358-A:3, I."[220] This exclusive authority was enacted in 2006.[221] It includes the power to order restitution, among a list of other potential remedies.[222] [223]

d) The Remedies Available under the Act for Regulated Entities and the Private Right of Action:

***Recommendation 3:***

***The Legislature should require that consumers alleging violations of the act against the entities regulated by the Departments of Banking or Insurance, the Public Utilities Commission or the Bureau of Securities Regulation (those entities currently exempt from the act) must first seek administrative enforcement of the allegation. Only after 90 days have passed from reporting the alleged violation to the regulator, could the consumer be permitted to bring a private court action for violations of the Consumer Protection Act.[224] This ensures that the regulator is made aware of the alleged behavior and has the opportunity to resolve it quickly without court involvement. However, after 90 days, the consumer would have the right to file suit if needed.***

***Recommendation 4:***

***To protect businesses from frivolous suits, the legislature should consider adding a provision to the act providing that if the court finds that a frivolous suit is brought under the act, the court shall award the defendant attorney fees and costs. Additionally, in order to protect these highly regulated industries (those currently***

[220] See RSA 421-B:21 (I-a) (g). It provides the Secretary of State this exclusive authority "notwithstanding any other provision of law."
[221] HB 716, chapter 245:20 (2006).
[222] See RSA 421-B:21 (I-a) (e).
[223] While the Insurance Department laws were amended in 2004 to provide it the authority to grant restitution, see RSA 417:10(II), there appears to be no similar language providing it the exclusive authority to investigate 358-A type practices. In fact, the Insurance Department does not investigate and prosecute unfair or deceptive act or practices in violation of RSA 358-A. Instead, the Insurance Department investigates and prosecutes unfair or deceptive acts or practices in violation of RSA 417---- the Unfair Insurance Trade Practices Act . This act is the equivalent of RSA 358-A, but much more carefully and specifically tailored to address the business of insurance However, the exemption to the CPA for trade or commerce that is subject to the jurisdiction of the insurance commissioner still applies.
[224] A similar process is required prior to bringing lawsuits alleging unlawful employment or housing discrimination. An injured party is first required to file a complaint regarding the alleged violation with the State Commission on Human Rights. See RSA 354-A .

***exempt from the act) from a deluge of suits motivated by the plaintiff receiving treble damages, the legislature should consider amending the act to provide that in the case of these highly regulated industries, if the court finds a violation of the act was willful or intentional and the court determines that double or treble damages is appropriate, the amount of punitive damages (the amount above restitution) shall be paid by the defendant to the regulating agency as a fine.***

The Legislature must decide the extent of the remedy that should be available for consumer protection actions by regulated entities. Currently, regulators may order restitution, revoke licenses and in some cases impose fines. When an injured party brings a private action under the CPA, a court may award injunctive relief, actual damages (or $1000, whichever is greater), up to three times damages for knowing or willful violations, and attorney fees and costs.[225] When the Attorney General's Office brings suit for violations of the act, the court can award civil penalties to the state of $10,000 per violation in addition to the other relief that is warranted.[226]

However, a private right of action for injured consumers is not currently available under the law for the regulated entities exempt from the Consumer Protection Act, specifically entities regulated by the Departments of Banking or Insurance, the Public Utilities Commission or the Bureau of Securities Regulation. Not permitting a private right of action in these circumstances only makes sense in an environment where the regulators have sufficient resources to investigate complaints and protect injured consumers. In a regulatory environment with insufficient resources or a lack of regulatory commitment to enforcement, eliminating the private right of action leaves consumers with little protection.

In comparison to a private lawsuit, regulatory enforcement of consumer protections, when it is effectively available, provides injured consumers with an easier, quicker and less expensive method of obtaining restitution. Likewise, it ensures that the regulator is made aware of any emerging pattern of questionable behavior of which it would be important for it to know. Additionally, the highly regulated entities who are already subject to strict regulatory oversight, benefit by avoiding potential litigation, and the possibility of frivolous lawsuits which may be motivated by the availability of treble damages.

The Legislature needs to adopt a system of remedies, that ensures injured consumers always have the ability to seek restitution but which also provides the benefits

[225] See RSA 358-A:10.
[226] See RSA 358-A:4.

of a regulatory remedy, including easier access to restitution for injured consumers and protections against frivolous suits for the highly regulated businesses.

e) Jurisdiction Between and Among Different Agencies

***Recommendation 5:***

***The Legislature should mandate the creation and operation of a Consumer Protection Working Group comprised of representatives of all regulator agencies that are charged with enforcing the Consumer Protection Act or other more targeted statutes protecting the public from unfair and deceptive trades and practices.[227] The working group shall meet regularly to share information, review trends, determine jurisdictional authority in complex cases and serve as a resource to each in the enforcement of the Act. The Attorney General or the Chief of the Consumer Protection Bureau in the Department of Justice should be charged with chairing the Consumer Protection Working Group.***

In today's complex commercial environment, determining the jurisdictional authority among and between different and overlapping agencies is a challenge. The FRM matter highlighted these difficulties.

Under current law, trade and commerce subject to regulation by the Banking Department is exempt from the Department of Justice's authority under the Consumer Protection Act.[228] Thus, according to the Attorney General Report and testimony, whenever the consumer protection bureau received a complaint involving an entity licensed by the Banking department they referred the matter to the Banking Department.[229] However, under NH law, the Banking Department has regulatory authority over residential lending but has no regulatory authority over commercial lending.[230] To the extent commercial lending may be covered under the CPA, the Department of Justice retains investigative and enforcement authority for those complaints. Nevertheless, the Consumer Protection Bureau referred all the FRM complaints to Banking, including those involving commercial mortgages which should have been retained by the Department of Justice.

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[227] For example, the Department of Insurance which is charged with enforcing insurance fraud pursuant to RSA 417 should also be made part of the working group.
[228] See RSA 358-A:3(I).
[229] "The Consumer Bureau has received five complaints regarding FRM. Because complaints related to banking are not within the jurisdiction of the Consumer Bureau, the complaints were all referred to the Banking Department and the files were closed." Report of the Attorney General to the Governor and Executive Council Financial Resources Mortgage, Inc., May 12, 2010, P. 48.
[230] Testimony of Richard Head, May 21, 2010, P. 101 – 102; Testimony of Peter Hildreth, May 14, 2010 P. 139 and 172-174, Testimony of Robert Fleury May 14, 2010, P. 169. Testimony of Celia Leonard, May 21, 2010, P. 84.

This example highlights the difficulty in determining where jurisdictional authority resides in particular cases. It points out the need not only to eliminate ambiguity over jurisdictional authority, but also for all the agencies involved in consumer protection activities to work collaboratively to identify who retains jurisdiction and responsibility regarding the complaints as they come in. Based on the testimony before the Joint Committee it appeared that each agency when addressing the jurisdiction question would ask: "Is this under our authority?" It is imperative that going forward the agencies work together to answer the question "Under whose authority does it fall?"

f) Interdepartmental Communications regarding Consumer Protection Violations

***Recommendation 6:***

***The Legislature should consider enacting a provision, requiring that all agencies receiving consumer complaints (alleging unfair and/or deceptive practices) be required to report the findings and disposition of the complaint to a central entity, most logically the Consumer Protection Bureau of the Department of Justice. Additionally, the statute should require that when one agency refers an alleged consumer protection violation to another agency, the receiving agency report back to the referring agency regarding the disposition of the referral.***

Prior to the 2004 amendments, the law required that the banking commissioner "report all consumer complaints by depositors to the consumer protection division of the office of the attorney general for record keeping and control purposes." The law further required that "when the complaint is resolved or the investigation is concluded without resolution, the commissioner shall send a report of his investigation, including findings of fact, to the consumer protection division." [231]

During testimony, the former attorney general implied that the repeal of the 2004 legislation that had required reporting back by the banking department hampered her office's ability to ensure proper oversight of the FRM complaints.[232] While it is true that the lack of follow-up reports from the Banking Department may have hindered effective

[231] Prior to 2004, the section read: 383:10-d. Consumer complaints.
"The commissioner shall report all consumer complaints by depositors to the consumer protection division of the office of the attorney general for record keeping and control purposes. The commissioner shall investigate the complaints. When the complaint is resolved or the investigation is concluded without resolution, the commissioner shall send a report of his investigation, including findings of fact, to the consumer protection division. 1985, 55:6, eff. April 23, 1985.
[232] Testimony of Former Attorney General Kelly Ayotte, June 14, 2010 p. 5-6, 20-21.

oversight of the FRM complaints, it should be pointed out that the pre-2004 legal requirement for Banking to send a report to the Department of Justice would not have covered the FRM complaints. The pre-2004 law applied to complaints "by depositors." The complaints related to FRM were not complaints "by depositors" and would not have been covered by the former law. Nevertheless, instituting a reporting back mechanism for record keeping and control purposes, especially one that covers all complaints, not merely those by depositors, would strengthen the state's consumer protection oversight.

2. Independent Authority of the Consumer Protection Bureau

***Recommendation 7:***

***The Legislature should clarify the scope of RSA 21-M:9 II (a) and (b) by determining whether the consumer protection bureau has an independent mandate for investigating and resolving complaints of unfair and deceptive practices under that statute- even of transactions that are exempted from the consumer protection act because they are regulated by other agencies.***

The Consumer Protection Bureau of the Attorney General's Office (CPB) derives its authority from RSA 21-M: 9, II.[233] That statute provides that the duties of the

[233] RSA 21-M;9 (II) provides that the "duties of the bureau shall include, but not be limited to, the following:

(a) Receiving, investigating, and attempting to resolve complaints by individual consumers of unfair or deceptive business practices.

(b) Bringing civil and criminal actions in the name of the state to redress unfair or deceptive trade or business practices.

(c) [Repealed.]

(d) Administering and enforcing the provisions of the land sales full disclosure act, RSA 356-A.

(e) Administering and enforcing the provisions of the condominium act, RSA 356-B.

(f) Administering the provisions of RSA 356-C, relative to protection of tenants in conversion of rental units.

(g) [Repealed.]

(h) Administering and enforcing the provisions of RSA 358-A, relative to regulation of business practices for consumer protection.

(i) Administering and enforcing the provisions of RSA 358-B, relative to chain distributor schemes.

(j) Administering and enforcing the provisions of RSA 358-C, relative to unfair, deceptive, or unreasonable collection practices.

(k) Administering and enforcing the provisions of RSA 358-D, relative to regulation of motor vehicle repair facilities.

(l) Administering and enforcing the provisions of RSA 358-E, relative to distributorship disclosure.

(m) Administering and enforcing the provisions of RSA 358-F, relative to sale of unsafe used motor vehicles.

(n) Administering and enforcing the provisions of RSA 358-G, relative to regulation of auctions.

(o) Administering and enforcing the provisions of RSA 358-H, relative to regulation of rental referral

Bureau **"shall include, but not be limited to"** a list of 18 different provisions. For purposes of this Report, the most important of these provisions is subsection (h), which provides that one of the duties of the Bureau includes administering and enforcing the provisions of RSA 358-A, the state Consumer Protection Act. But as discussed above, RSA 358-A:3 provides a regulated industries exemption from the act, thus eliminating the CPB's authority under that statute for certain cases.

However, of the 18 provisions which the statue includes, but to which the CPB's duties are not limited, only the last 16 list the enforcement of specific consumer protection statutes. The first two provisions list more general duties of the Bureau as being:

(a) Receiving, investigating, and attempting to resolve complaints by individual consumers of unfair or deceptive business practices.

(b) Bringing civil and criminal actions in the name of the state to redress unfair or deceptive trade or business practices.

It is unclear whether these 2 general subsections provide the CPB with an independent duty and authority to investigate, attempt to resolve and bring enforcement actions in response to consumer complaints of unfair and deceptive practices, outside the context of any specific statutory frameworks (possibly utilizing common law and equity theories to obtain a remedy).

If the CPB's authority is meant to be limited only to the 16 specific statutory frameworks listed, without a separate general duty, then the exemption under RSA 358-A:3 for regulated activity should appropriately be meant to limit all authority of the Bureau of Consumer Protection in these instances.

However, if subsections (a) and (b) are meant to provide authority that goes beyond the 16 listed statutory frameworks, then the office of consumer protection may have an independent authority beyond 358-A to "receive, investigate an attempt to resolve complaints by individual consumers of unfair and deceptive trade or business practices."

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agencies.

(p) Administering and enforcing the provisions of RSA 358-I, relative to regulation of health clubs.

(q) Administering and enforcing the provisions of RSA 358-J, relative to regulation of buying clubs.

(r) Administering and enforcing the provisions of RSA 359-B, relative to consumer credit reporting.

(s) Administering and enforcing antitrust laws, including the provisions of RSA 356, relative to combinations and monopolies.

(t) [Repealed.]

(u) Investigating and prosecuting disciplinary proceedings before state professional licensing boards."

Similarly, the Bureau would also have the authority to bring civil and/or criminal actions in the name of the state to the extent that such claims or actions were available. (However, the exemption under 358-A:3 could be read as prohibiting the Bureau from bringing any claims under that statutory structure.)[234]

The testimony of a former Consumer Protection Bureau Chief implies that the Department of Justice takes the position that once the RSA 358-A:3 exemption applies, the Bureau does not have independent authority under RSA 21-M:9 II (a) and (b) to investigate, attempt to resolve and enforce the complaints. [235]

It is important that the Legislature clarify if the Consumer Protection Bureau should have independent jurisdiction beyond the narrow statutory claims enumerated in the Consumer Protection Act to protect the public utilizing other legal theories, such as common law claims.

## IX. Interdepartmental communication and cooperation

The FRM hearings demonstrated the need for enhanced interdepartmental communication and cooperation. The lack of such communication and cooperation resulted in many missed opportunities for regulatory intervention in regard to FRM. As noted earlier in the report, the lack of communication and cooperation is evidenced by:

- Department of Banking's unwillingness to share their examination reports of FRM with the other agencies, particularly the BSR.
- The unwillingness of the Bureau of Securities Regulation to conduct a joint site investigation with Banking of FRM
- The Attorney General's Office automatic referral of complaints to Banking without further discussions as to resolution by Banking or the existence of the jurisdiction for commercial mortgages by the Department of Justice.

[234] The determination regarding whether the CPB retains independent authority under 21-M:9 impacts the meaning of the "exclusive authority and jurisdiction to investigate conduct that is or may be an unfair or deceptive act or practice under RSA 358-A and exempt under RSA 358-A:3, I" that has been provided to the Banking Department and the Bureau of Securities Regulation. If this exclusive authority is meant to limit the investigation of the conduct generally, then the more narrow reading of CPB powers under 21-M:9 is appropriate. However, if the exclusive authority is meant to limit the investigation of claims under the Consumer Protection Act RSA 358-A, then the broader interpretation of the CPB's duties under RSA 21-M:9 is warranted. In either case the Legislature should remove the ambiguity by clarifying the scope of RSA 21-M:9 II (a) and (b).

[235] Testimony of Richard Head, May 21, 2010 Hrg. Transcript at p.43.

- Failure of communication between the Consumer Protection, Civil and Criminal Bureaus within the Department of Justice regarding FRM matters before them.
- The narrow agency analysis by all three agencies of their jurisdiction in regard to FRM without ever cooperating to determine with whom proper jurisdiction resided.

Based on the testimony before the Joint Committee it appeared that each agency when addressing the jurisdiction question would ask: "Is this under our authority?" It is imperative that going forward the agencies work together to answer the question "Under whose authority does it fall?"

Recommendations already included in this report effectively address this lack of interdepartmental cooperation and communication.

Additionally, the recommendation below regarding the creation of centralized consumer protection database could be an important tool in fostering the necessary interdepartmental communication. In addition to the information that would be available publically pursuant to such a database, it could be structured to permit the agencies additional information to aid in information sharing and cooperation.

## X. Communication with the public and mechanisms for providing public notice regarding consumer protection complaints

Finding: New Hampshire Consumers Have No Easily Accessible Way of Finding Out if a Business Entity Has Been the Subject of Substantiated Consumer Complaints or Regulatory Enforcement Action

***Recommendation:***

***The Legislature should consider the creation of a centralized consumer complaint database where citizens can look up substantiated consumer complaints across all regulatory agencies.***

During public testimony, injured persons repeatedly reported attempting to contact both the Attorney General's Office and the regulators involved, particularly the Department of Banking, to determine whether there were complaints or findings against

FRM.[236] It was reported by these individuals that they were not informed regarding pending complaints before these regulatory agencies.[237] They claimed that had they had the information regarding pending complaints they could have avoided trusting FRM with their money.[238]

It is critical that there be a centralized public database where citizens could research the existence of substantiated complaints against businesses so that they can be fully informed in making their decisions. The Attorney General has also identified the need for a centralized database where all regulatory agencies can share information with each other in order to identify unlawful conduct, like Ponzi schemes, earlier.[239]

Current law permits the Bureau of Consumer Protection to "disclose to the public the number and type of complaints or inquiries filed by consumers against a particular person … provided, however, that no such disclosure shall abridge the confidentiality of consumer complaints or inquiries."[240]

While the Banking statute provides that all information of investigations shall remain confidential and not subject to public disclosure, there is an exception that allows the Commissioner of Banking to disclose the information publically when, he finds that "the ends of justice and the public advantage will be subserved by the publication" of the information.[241] The Banking Commissioner, on his own initiative or as directed by new legislation could order the disclosure of complaints, investigations, and examinations to a centralized database.

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[236] See Hearing Audio May 28, 2010.
[237] Id.
[238] Id.
[239] Testimony of Michael Delaney, May 21, 2010, p. 48-49. "We've talked about a centralized database where regulators within the State would be able to go behind any confidentiality laws that may exist for any particular industry and have full access to contacts with the State of New Hampshire. We do not have that system right now. We've identified those as recommendations of things that if they were in place in 2000 may have made a difference that we'd like to see get in place starting in 2010 so that maybe they will make a difference in the future."
[240] RSA 21-M:9 (III). According to Attorney Head: "With regard to complaints that are received by the Consumer Protection Bureau, those by statute are confidential. Our interpretation of that is that we can disclose the number of complaints against a particular entity and the nature of the complaint that was filed, but we do not provide copies of the complaint. We do not disclose the identity of the individual who has filed a complaint against us." June 21, 2010 Hrg. Transcript p. 59.
[241] RSA 383:10-b. Note Testimony of Robert Fluery, June 21, 2010 Hrg. Transcript p. 90 where he indicated that until disclosed pursuant to an order by the Banking Commissioner, examinations are strictly confidential.

Similarly, the Secretary of State has the discretion to publish the comments and recommendations of the examiners within the BSR.[242]

A publically accessible centralized database regarding consumer protection complaints will provide the public with a powerful tool in assembling critical information in deciding how to behave in the marketplace.

[242] RSA 421-B:9(VI).