Consumer Compliance Outlook

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Inside

A Federal Reserve System Publication with a Focus on Consumer Compliance Issues

New Regulation Z Rules Enhance Protections for Mortgage Borrowers*

By Karin Modjeski Bearss, Senior Examiner, Federal Reserve Bank of Minneapolis

OVERVIEW AND BACKGROUND

In response to concerns about unfair and deceptive mortgage lending and servicing practices, the Board of Governors of the Federal Reserve System (Board) issued significant new mortgage lending rules,[1] which take effect on October 1, 2009, except for the new escrow rules. Federal Reserve Chairman Ben S. Bernanke stated that these new rules are "intended to protect consumers from unfair or deceptive acts or practices in mortgage lending, while keeping credit available to qualified borrowers and supporting sustainable home ownership."[2] As a result, the rule's strongest prohibitions are aimed at curbing questionable lending practices that occurred in the subprime mortgage market; however, some provisions apply to all consumer mortgages.

The rules amend Regulation Z, the implementing regulation for the Truth in Lending Act (TILA), and are issued using the Board's rulemaking authority for the Home Ownership and Equity Protection Act of 1994 (HOEPA) to prohibit deceptive acts and practices for mortgage loans and abusive acts or practices for refinancings.[3] In addition to expanding protections for subprime and other consumer mortgage loans, the rules also impose restrictions on mortgage advertising. This article will discuss the specifics of the new rules and conclude with recommendations for implementing the changes.

DISTINGUISHING NEW HIGHER-PRICED LOANS FROM EXISTING HOEPA LOANS

Many of the key provisions of the rule relate to higher-priced loans, a new category of mortgage loans within Regulation Z containing expanded consumer protections. This new loan category should not be confused with existing HOEPA loans, often referred to as "section 32" loans. Higher-priced loans have lower triggers than HOEPA loans and therefore encompass more

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*A more detailed version of this article is available online at http://www.consumercomplianceoutlook.org.

[1] The Board issued the rules on July 14, 2008. http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm. The *Federal Register* notice is available at http://edocket.access.gpo.gov/2008/pdf/E8-16500.pdf.

[2] http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm

[3] Some parts of the rulemaking also relied on the Board's general authority under §105(a) of TILA to prescribe regulations necessary or proper to carry out TILA's purposes.

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Regulation B and Marital Status Discrimination: Are You in Compliance?

By Carol Evans, Special Counsel for Fair Lending, and Surya Sen, Supervisory Consumer Financial Services Analyst, Board of Governors of the Federal Reserve System

Boards of directors and their senior management strive to develop strong programs for managing compliance risk to shield their institutions from the legal and reputational risks associated with fair lending violations. While most institutions are successful at maintaining compliance with federal fair lending laws, some struggle with finding ways to protect themselves from the fair lending risk of marital status discrimination. Marital status discrimination is one of the most challenging forms of discrimination to understand and one of the most often cited violations of Regulation B, the implementing regulation for the Equal Credit Opportunity Act. Understanding the marital status provisions in Regulation B can help institutions avoid violations and ensure that their customers are treated fairly and responsibly.

Some of the more common fair lending violations related to marital status occur in the following areas:

1. improperly requiring spousal signatures on loan documents;
2. failing to establish the intent to apply for joint credit;
3. improperly limiting additional parties to spouses; and
4. improperly taking marital status into account during underwriting.

To help lenders maintain compliance with Regulation B, this article clarifies these issues.

SPOUSAL SIGNATURES

Section 202.7(d) of Regulation B generally provides that a creditor shall not require the signature of an applicant's spouse who is not a joint applicant on any credit instrument if the applicant qualifies on his or her own, unless certain specified exceptions are met:

- when the spouse's signature is necessary *as a matter of state law* to provide a secured creditor access to collateral in the event of default, or to give an unsecured creditor access to property otherwise relied upon in the event of death or default; or
- when the spouse is providing credit support because the primary applicant does not meet the creditor's lending standards (but, as discussed below, when an additional party is needed, a creditor may not require that it be a spouse).

For example, regarding secured credit, a creditor may require spousal signatures on any instrument reasonably believed to be necessary under applicable state law to ensure access to the property in the event of default.[1] Accordingly,

[1] Specifically, §202.7(d)(4) provides that "[i]f an applicant requests secured credit, a creditor may require the signature of the applicant's spouse or other person on any instrument necessary, or reasonably believed by the creditor to be necessary, under applicable state law to make the property being offered as security available to satisfy the debt in the event of default . . . ."

if obtaining a spouse's signature on a mortgage or other security instrument is sufficient under state law, a lender may not require the spouse to sign the note.[2] Additionally, if a creditor determines that a spousal signature is required by state law on an instrument that imposes personal liability, the determination should be supported with a careful legal analysis.[3]

Similar standards apply for unsecured credit.[4] Section 202.7(d)(2) of Regulation B provides that "[i]f an applicant requests unsecured credit and relies in part upon property that the applicant owns jointly with another person to satisfy the creditor's standards of creditworthiness, the creditor may require the signature of the other person only on the instrument(s) necessary, or reasonably believed by the creditor to be necessary, under the law of the state in which the property is located, to enable the creditor to reach the property being relied upon in the event of the death or default of the applicant."

In the case of a loan to a business, a lender may require the personal guarantees of the partners, directors, or officers of a business and the shareholders of a closely held corporation, but the requirement for a guarantee must be based on the guarantor's relationship to the business, not on a prohibited basis.[5] A lender may not require the signature of a guarantor's spouse, unless one of the exceptions in §202.7(d) is met.[6]

ESTABLISHING JOINT INTENT

Creditors should obtain evidence of an applicant's intent to apply for joint credit at the time of application and should not assume that an applicant intends to apply jointly with a spouse. The Official Staff Commentary for Regulation B provides guidance on proper documentation of a borrower's intent to be a joint applicant:

> A person's intent to be a joint applicant must be evidenced at the time of application. Signatures on a promissory note may not be used to show intent to apply for joint credit. On the other hand, signatures or initials on a credit application affirming applicants' intent to apply for joint credit may be used to establish intent to apply for joint credit. The method used to establish intent must be distinct from the means used by individuals to affirm the accuracy of information. For example, signatures on a joint financial statement affirming the veracity of information are not sufficient to establish intent to apply for joint credit.[7]

Banks may reference or adopt the model forms provided in Appendix B to Regulation B to meet the regulation's requirements for documenting borrower intent.

CREDITORS SHOULD OBTAIN EVIDENCE OF AN APPLICANT'S INTENT TO APPLY FOR JOINT CREDIT AT THE TIME OF APPLICATION AND SHOULD NOT ASSUME THAT AN APPLICANT INTENDS TO APPLY JOINTLY WITH A SPOUSE.

Lenders are cautioned to ensure that these forms are properly completed to show intent. Examiners sometimes find instances in which the box indicating joint intent was not checked, but both spouses had signed

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[2] The Official Staff Commentary on Regulation B cautions that a creditor "may not require the spouse to sign the note evidencing the credit obligation if signing only the mortgage or other security agreement is sufficient to make the property available to satisfy the debt in the event of default." Supplement I to Regulation B, Comment 202.7(d)(4)-1.

[3] See Comment 202.7(d)(4)-2: "A creditor's reasonable belief that, to ensure access to the property, the spouse's signature is needed on an instrument that imposes personal liability should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general."

[4] For detailed guidance regarding community property states, see §202.7(d)(3).

[5] Comment 202.7(d)(6)-1.

[6] Comment 202.7(d)(6)-2.

[7] Comment 202.7(d)(1)-3 (internal citations omitted).

Affiliate Marketing Rules*

By Dean A. Pankonien, Assistant Vice President. Federal Reserve Bank of Dallas, and Diane van Gelder, Director, Examinations, Federal Reserve Bank of Dallas

The Federal Financial Institutions Examination Council (FFIEC) recently approved examination procedures for the affiliate marketing rules[1] of §624 of the Fair Credit Reporting Act[2] (FCRA), which the Board of Governors of the Federal Reserve System implements for the institutions it supervises through Regulation V. This article reviews the regulatory requirements for affiliate marketing. For the reader's convenience, the examination procedures are available on page 19.

SECTION 624'S REQUIREMENTS

The rules apply to information obtained from the consumer's transactions or account relationships with an affiliate, from any application the consumer submitted to an affiliate, and from third-party sources such as credit reports, if the information is to be used to make marketing solicitations to the consumer. The deadline for mandatory compliance was October 1, 2008.

Under the rules, a consumer can restrict an entity, with which it does not have a pre-existing business relationship, from *using* certain information obtained from an affiliate to make solicitations to that consumer. This provision is distinct from other sections of the FCRA that allow consumers to restrict the *sharing* of consumer information among affiliates.

A bank and its subsidiaries may not use eligibility information about a consumer that they receive from an affiliate for marketing purposes unless certain exceptions apply. Before the information may be used, it must be clearly and conspicuously disclosed that the information about that consumer may be used to make marketing solicitations. In addition, the consumer must have a reasonable opportunity and simple method to "opt out" and to prohibit the bank and its subsidiaries from using eligibility information for marketing purposes. The opt-out notice must be provided by an affiliate that has or had a pre-existing business relationship with the consumer or as part of a joint notice, where at least one of the affiliates providing the joint notice has or had a pre-existing business relationship with the consumer.

> A BANK AND ITS SUBSIDIARIES MAY NOT USE ELIGIBILITY INFORMATION ABOUT A CONSUMER THAT IT RECEIVES FROM AN AFFILIATE FOR MARKETING PURPOSES UNLESS CERTAIN EXCEPTIONS APPLY.

DEFINITIONS

For consistency, the following terms are defined in the rules.

Eligibility information includes not only transaction and experience information but also the type of information found in consumer reports, such as information from third-party sources and credit scores. Eligibility information does not include aggregate or blind data that do not contain personal identifiers, such as account numbers, names, or addresses.

A **pre-existing business relationship** means a relationship between a person,[3] such as a financial institution, and a consumer based on:

- a financial contract that is in force on the date the solicitation is sent;
- the purchase, rental, or lease by the consumer of a person's goods or services, or a financial transac-

*A more detailed version of this article is available online at http://www.consumercomplianceoutlook.org.

[1] http://www.federalreserve.gov/boarddocs/caletters/2008/0806/caltr0806.htm

[2] http://www4.law.cornell.edu/uscode/html/uscode15/usc_sec_15_00001681---s003-.html

[3] Section 222.3(l) of the regulation broadly defines "person" as "any individual, partnership, corporation, trust, estate cooperative, association, government or governmental subdivision or agency, or other entity." http://edocket.access.gpo.gov/cfr_2008/janqtr/12cfr222.3.htm

tion between the consumer and the person, during the 18-month period immediately preceding the date the solicitation is sent; or
- an inquiry or application by the consumer regarding a product or service offered during the three-month period immediately preceding the date the solicitation is sent.

The **types of solicitations** covered include telemarketing, regular mail, e-mail, or other forms of marketing communication directed to a particular consumer that is based on eligibility information received from an affiliate. A solicitation does not include marketing communications that are directed at the general public (e.g., television, general circulation magazines, and billboard advertisements).

For example, a consumer has a homeowner's insurance policy with an insurance company. The insurance company shares eligibility information about the consumer with its affiliated bank. The bank wants to use that information to market its home equity loan products to the consumer but does not have a pre-existing business relationship with the consumer. The bank may not use eligibility information it received from the insurance company to make solicitations to the consumer unless the insurance company gave the consumer a notice and the opportunity to opt out, and the consumer did not opt out.

The bank may not use eligibility information it received from the insurance company to make solicitations to the consumer unless the insurance company gave the consumer a notice and the opportunity to opt out, and the consumer did not opt out.

Constructive sharing occurs when the bank provides criteria that were not derived from eligibility information to its affiliate for consumers to whom it would like the affiliate to market the bank's products. Then, based on these criteria, the affiliate uses eligibility information that the affiliate obtained in connection with its own pre-existing business relationship with the consumer to market the bank's products or services. Constructive sharing also occurs when a service provider, applying the bank's criteria, uses information from an affiliate, such as that in a shared database, to market the bank's products or services to the consumer. Constructive sharing does not involve the use of eligibility information; therefore, the affiliate marketing rules do not apply.

OPTING OUT

The consumer must be given a reasonable and simple method for opting out and may opt out at any time. The opt-out period must be at least five years, but it can be longer. The consumer may revoke the opt-out in writing or electronically.

The opt-out notice must be provided so that each consumer can reasonably be expected to receive the notice. For example, if the affiliate sends the notice via e-mail to a consumer who has not agreed to receive electronic disclosures from it, the notice is not reasonable.

An affiliate that has or previously had a pre-existing business relationship with the consumer can provide the notice either individually or as part of a joint notice from two or more members of an affiliated group of companies.

After the opt-out period expires, a bank may not make solicitations based on eligibility information it receives from an affiliate to a consumer who previously opted out, unless the consumer received an opportunity to opt out and did not renew the opt-out. A bank could also make solicitations if one of the exceptions to the notice and opt-out requirements, which are discussed below, applies.

NOTICES

Opt-out and renewal notices must be clear, conspicuous, and concise. The initial notice must accurately disclose items such as:

- the name of the affiliate(s) providing the notice;
- a list of the affiliates or types of affiliates whose use

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The Community Reinvestment Act and Minority-Owned Financial Institutions

By Carole M. Foley, Supervising Examiner, Federal Reserve Bank of Philadelphia

Minority-owned financial institutions (minority institutions[1]) play an important role in addressing financial services needs in the minority and low-income communities they serve. This article discusses how majority-owned financial institutions (majority institutions) may aid minority institutions in achieving their goals and at the same time fulfill their obligations under the Community Reinvestment Act (CRA).

> Under the CRA, majority institutions may receive favorable CRA consideration when they provide investments, loans, financial services, and technical assistance to minority institutions.

Congress amended §2903(b) of the CRA in 1992 to state specifically that majority institutions may obtain CRA credit for helping minority institutions.[2] To clarify this issue, the Federal Financial Institutions Examination Council (FFIEC) agencies added CRA questions and answers[3] that provide guidance on how providing assistance to minority institutions may qualify for CRA consideration, including examples of such activities. The agencies also reaffirmed this in a joint letter to Congress in January 2006.[4]

Under the CRA, majority institutions may receive favorable CRA consideration when they provide investments, loans, financial services, and technical assistance to minority institutions. In turn, these activities allow minority institutions to respond effectively to demand for affordable financial products and services in economically distressed markets and by low- and moderate-income individuals, consistent with safe and sound banking practices.

INVESTMENTS IN MINORITY INSTITUTIONS

An institution may receive favorable CRA consideration if it invests in a minority institution that serves low- or moderate-income areas or individuals, even if the minority bank is not located in the assessment area of the investing bank, or within the broader statewide or regional areas that include the investing bank's assessment area. A qualified community development investment may be in the form of a lawful investment, deposit, grant, or donation, or in-kind contribution of property. Some examples of qualified investments are:

- A majority institution may buy certificates of deposit from a minority bank serving mainly low- and moderate-income communities.
- A majority institution may purchase the stock of a minority bank to provide the capital needed to expand its franchise [Regulation H, §208.22].
- A majority institution with assessment areas in other parts of the country may make a qualified capital investment in a minority bank serving an area affected by hurricanes Katrina and Rita.
- A majority institution may donate, sell on favorable terms, or make available to a minority bank on a rent-free basis a branch of the bank that is lo-

[1] The terms "minority depository institution" and "minority" are defined in the CRA statute at 12 U.S.C. §2907(b). http://www.law.cornell.edu/uscode/html/uscode12/usc_sec_12_00002907----000-.html.

[2] http://www.law.cornell.edu/uscode/html/uscode12/usc_sec_12_00002903----000-.html

[3] "Interagency Questions and Answers Regarding Community Reinvestment," http://www.ffiec.gov/cra/qnadoc.htm (community development investments at §§__.12(s) & 563e.12(r) – 4 and community development lending at §§__.12(i) & 563e.12(h) – 1.

[4] http://www.ffiec.gov/cra/pdf/minorityownedinstitutions.pdf

cated in a predominantly minority neighborhood [Regulation BB, §228.23(d)].

LENDING TO MINORITY INSTITUTIONS

A majority institution may receive favorable CRA consideration if it makes a loan to a minority institution that serves low- or moderate-income areas or individuals. Community development loans include both direct loans and loan participations purchased by majority institutions. Minority and majority institutions may establish two-way correspondent relationships on loan business as follows:

- A majority institution may purchase participations in loans made by a minority institution to businesses in the minority bank's community to help reduce the credit exposure of the minority bank.
- Likewise, a majority institution may invite a minority bank to participate in a large commercial credit facility, the proceeds of which were used to provide credit to a business located in the minority institution's assessment area.

PROVIDING SERVICES TO MINORITY INSTITUTIONS

A majority institution may receive favorable CRA consideration if it provides financial services to a minority institution that serves low- or moderate-income areas or individuals. Community development services include providing technical assistance on financial matters to a minority bank. For example:

- Majority institutions may permit officers to sit on the boards of directors of minority banks to provide technical assistance on financial matters, provided they conform to the "small market share" exemption to management interlocks [Regulation L, §212.5].
- A majority institution may develop a relationship with a minority institution in the majority institution's area to allow the minority institution's customers to use ATM machines in the majority institution's area. The availability of no fee or low fee ATM access provides low- and moderate-income consumers greater access to banking services.
- Majority institutions may offer employee training or consulting on bank operations to minority institutions.

CONCLUSION

When a majority institution engages in qualified CRA activities with a minority institution, both institutions benefit: The majority institution receives CRA credit while helping the minority institution reach its goals. If you have questions about whether your bank will receive CRA credit for specific loans, investments, or services provided to a minority institution, please consult with the consumer compliance contact at your supervising Reserve Bank or your primary regulator.

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Reverse Mortgages and Consumer Protection Issues

by John S. Insley, Jr. Principal Examiner, Bank Supervision and Regulation, Federal Reserve Bank of Richmond

The growth in the number of seniors in the U.S. population in conjunction with housing market developments, notably private securitization, has stimulated broad interest and substantial growth in reverse mortgages in recent years. As a result, it is increasingly likely that many banks and others involved in the traditional mortgage business may consider originating reverse mortgages or be afforded opportunities to participate indirectly in the reverse mortgage market. Despite recent troubles in the national mortgage market, reverse mortgages are growing at a rapid rate: "Expansion of this hot spot in mortgage lending is expected to continue owing to increasingly flexible products, new sources of capital, and a growing supply of potential borrowers. As the reverse mortgage market develops, it is important that potential borrowers be educated about this complex product to protect them from taking out unsuitable loans."[1]

WHAT IS A REVERSE MORTGAGE?

As the name suggests, reverse mortgages share similarities with traditional mortgages, but the flow of payments during the loan term is reversed. The borrower receives payments or access to funds with no obligation to repay the principal or interest until the loan is due. The U.S. Department of Housing and Urban Development (HUD) describes a reverse mortgage as "a special type of home loan that lets a homeowner convert a portion of the equity in his or her home into cash. The equity built up over years of home mortgage payments can be paid to you. But unlike a traditional home equity loan or second mortgage, no repayment is required until the borrower(s) no longer use the home as their principal residence."[2]

According to the National Reverse Mortgage Lenders Association (NRMLA), home equity conversion mortgages (HECM), the reverse mortgage product insured by the Federal Housing Administration (FHA), a federal agency within HUD, account for 90 percent of all such loans extended.[3] Under the FHA

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[1] Heidi Kaplan, "Reverse Mortgages—the Next Hot Spot," *Bridges*, Federal Reserve Bank of St. Louis (Spring 2008). http://www.stlouisfed.org/publications/br/2008/a/pages/1-article.html

[2] http://www.hud.gov/offices/hsg/sfh/hecm/rmtopten.cfm

[3] http://www.nrmlaonline.org/rms/statistics/default.aspx?article_id=601

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New Regulation Z Rules Enhance Protections for Mortgage Borrowers

loans. In addition, the rule for higher-priced loans applies to purchase money mortgages, which are excluded from HOEPA's coverage. But like HOEPA, the final rule for higher-priced loans excludes home equity lines of credit (HELOCs) and construction and reverse mortgage loans. The final rule also prohibits lenders from structuring a closed-end higher-priced loan as an open-end line of credit to evade the rule's protections. The rule for HOEPA loans remains in effect, albeit with some enhancements.

New Higher-Priced Loan Triggers

Identifying higher-priced loans will be a critical part of complying with these new rules. A higher-priced loan is defined as a "consumer credit transaction secured by a consumer's principal dwelling with an annual percentage rate (APR) that exceeds the average prime mortgage offer rate for a comparable transaction as of the date the interest rate is set by:

- 1.5 or more percentage points for loans secured by a first lien on a dwelling, or
- 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling."[4]

The Board will publish average prime offer rates on a weekly basis on the website of the Federal Financial Institutions Examination Council. Initially, the Board will base the rates on the Freddie Mac Primary Mortgage Market Survey (PMMS), which is published weekly.[5]

NEW CONSUMER PROTECTIONS FOR HIGHER-PRICED AND HOEPA LOANS

The new rule adds new protections for higher-priced loans and enhances existing protections for HOEPA loans. The new protections include prohibiting lenders from making loans based on collateral without regard to repayment ability, requiring lenders to verify income and obligations, and imposing more stringent restrictions on prepayment penalties. The rule also requires lenders to establish escrow accounts for taxes and mortgage-related insurance for first-lien loans.

Ability to Repay and Verification of Income and Assets

The final rule prohibits a lender from extending any higher-priced or HOEPA loan without regard to the borrower's repayment ability. The rule also requires lenders to confirm repayment ability by examining current and reasonably expected income, employment, assets other than collateral, current obligations, and mortgage-related obligations, such as expected property tax and insurance obligations.

The final rule provides a "presumption of compliance" safe harbor for the repayment ability requirement if the creditor can show that it:

- confirms the consumer's repayment ability by verifying income or assets through tax forms, payroll receipts, financial institution records, or other third-party documents relied on for repayment;
- analyzes the consumer's repayment ability using the largest payment of principal and interest scheduled in the first seven years following consummation and takes into account current obligations, including mortgage-related obligations; and
- evaluates the consumer's repayment ability taking at least one of the following into account: the ratio of total debt obligations to income or the income remaining after paying debt obligations.

Prepayment Penalty Provisions

The final rule imposes significant restrictions on the use of prepayment penalties for both higher-priced and HOEPA loans. The rule prohibits penalties if a loan's payment can change during the first four years. For all other higher-priced and HOEPA loans, a prepayment penalty:

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[4] §226.35(a)(1)

[5] The Board discussed the methodology for calculating average prime offer rates in an attachment to a recent amendment to Regulation C. http://edocket.access.gpo.gov/2008/pdf/E8-25320.pdf

- must be otherwise permitted by law;
- may apply only during the loan's first two years; and
- may not apply if it results from a refinancing with the creditor or the creditor's affiliate.

In addition, the regulation continues to prohibit prepayment penalties for HOEPA loans if the consumer's monthly debt payments at consummation exceed 50 percent of the consumer's gross income.

Escrow Requirements

The final rule requires creditors to establish an escrow account for property taxes and mortgage-related insurance required by the creditor before consummation for higher-priced, first-lien loans secured by the borrower's principal dwelling. Creditors may provide the borrower with an opportunity to cancel the escrow account no earlier than 12 months from consummation; the borrower must make this request in writing.

Coverage. The scope of the escrow requirement includes higher-priced loans for manufactured housing that are secured by a borrower's principal dwelling, even if the manufactured housing is considered personal property under state law. The rule also covers higher-priced, first-lien loans on condominium and cooperative units when the property is the borrower's principal residence. The rule clarifies, however, that creditors need not establish escrow accounts for loans secured by shares in a cooperative; in such cases, the cooperative association pays the property taxes and insurance. In addition, although escrow accounts are required for property taxes on condominiums, creditors need not escrow insurance if the condominium association must maintain a master insurance policy covering all units.

Effective Dates. The final rule provides an extended effective date for the escrow account requirement because the industry will have to adjust its systems and infrastructure to provide such accounts. Specifically, creditors must establish escrow accounts for covered loan applications received on or after April 1, 2010. For covered loans secured by manufactured housing, the escrow rule covers applications received on or after October 1, 2010.

NEW REQUIREMENTS FOR ALL LOANS SECURED BY PRINCIPAL DWELLING

In addition to new consumer protections for higher-priced loans, the final rule prohibits coercion of appraisers, defines inappropriate practices for loan servicers, and requires early truth in lending disclosures for most mortgages.[6]

IMPROPER COERCION OCCURS IF A LENDER EXCLUDES AN APPRAISER FROM FUTURE WORK BECAUSE THE APPRAISER DID NOT VALUE A DWELLING AT THE LENDER'S MINIMUM STANDARD.

Coercion of Appraisers

For loans secured by a principal dwelling, other than HELOCs, the final rule prohibits creditors, mortgage brokers, and their affiliates from directly or indirectly coercing, influencing, or otherwise encouraging an appraiser to misstate or misrepresent a dwelling's value. The rule also prohibits a creditor from originating a loan based on an appraisal the creditor knows violates this rule "unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling."[7]

To facilitate compliance, the regulation identifies several examples of actions that would violate the appraiser coercion rule. For instance, improper coercion occurs if a lender excludes an appraiser from future work because the appraiser did not value a dwelling at the lender's minimum standard. Failing to pay an appraiser for similar reasons would also violate this rule. The regulation also identifies actions that would not violate this rule. For example, requesting that an

[6] The Housing and Economic Recovery Act of 2008 (HERA) contains amendments to TILA that codify some of these requirements and impose additional ones. The TILA amendments appear in sections 1403, 2501, and 2502 of HERA. The full text of HERA is available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_public_laws&docid=f:publ289.110.pdf.

[7] §226.36(b)(2)

appraiser provide additional information to support a valuation and asking an appraiser to correct factual errors are acceptable appraiser-related actions.

Prohibited Loan Servicer Practices

The final rule also regulates loan servicing entities with respect to certain unfair and abusive practices. Specifically, with regard to servicing loans secured by a principal dwelling, the final rule prohibits such entities from:

- failing to credit a payment to an account as of the date received;
- pyramiding late fees; and
- failing to provide an accurate loan payoff statement within a reasonable time of receiving a request for such a statement.[8]

The Board adopted these prohibitions to address concerns that by failing to credit payments in a timely manner or by pyramiding late fees, loan servicers were assessing unwarranted or excessive fees and, at times, improperly providing negative credit report information on consumers. In addition, failing to provide a timely payoff statement can result in delays if a consumer is trying to refinance an existing loan or increase closing-related transaction costs.

Pyramiding late fees is the practice of assessing a late fee when a timely and complete payment has been made and the only outstanding balance is a previously unpaid late fee or delinquency charge. While this practice is currently prohibited by the Board's Regulation AA and the Federal Trade Commission's credit practice rule, adding this prohibition to TILA will allow state attorneys general to enforce this provision; thus, the rule will provide additional consumer protections.

Coverage. Consistent with the Department of Housing and Urban Development's Regulation X, the new rule defines a servicer as the person responsible for servicing a mortgage loan; it includes the loan originator if that person also services the loan.

Early TILA Disclosure Requirements

Regulation Z currently requires early disclosures only for loans to acquire or construct a consumer's dwelling. The final rule expands this coverage to provide early TILA disclosures for any closed-end loan subject to the Real Estate Settlement Procedures Act and secured by a principal dwelling; the rule does not apply to home equity lines of credit.[9] In addition, a new requirement prohibits a lender or any person from collecting a fee, other than a credit report fee, from a borrower until after the borrower has received the early TILA disclosures. For mailed disclosures, the lender may assume that the disclosures have been received three days after mailing and assess a fee at that time.

NEW ADVERTISING REQUIREMENTS AND RESTRICTIONS

The final rule contains new advertising requirements for both closed- and open-end mortgage loans. These changes are meant to improve the clarity of information included in mortgage-related advertisements as well as provide outright bans on certain misleading advertising practices.

Significant Closed-End Loan Advertising Rules

Clear and Conspicuous Standard. The Board added a specific clear and conspicuous standard that applies to all closed-end loan advertisements. This new standard complements the existing clear and conspicuous standard in Regulation Z that applies to all closed-end credit disclosures. The accompanying commentary outlines several practices needed to comply with the clear and conspicuous standard for loans secured by dwellings.

Disclosure Changes to Advertisements for Dwelling-Secured Loans. Under the new rules, advertisements for home-secured loans may include only the simple annual interest rate, or the rate at which interest will accrue, along with and not more conspicuously than the disclosed APR. In addition, if an advertisement for a dwelling-secured loan includes a simple annual interest rate, such as a teaser rate, and more than one rate may apply during the loan's term, the advertisement must include:

- each simple annual rate of interest that will apply;
- the time period for which the rate will apply; and
- the loan's APR.

[8] §226.36(c)(1)

[9] In addition to the final rule's new early disclosure requirements, the TILA amendments appearing in sections 2501 and 2502 of HERA contain a similar requirement and impose additional ones. The TILA amendments are known as the Mortgage Disclosure Improvement Act of 2008.

If an advertisement for a dwelling-secured loan states any payment amount, the advertisement must include:

- the amount of each payment that will apply during the loan's term, including any balloon payment;
- the period of time each payment will apply; and
- the fact that the payments do not include taxes and insurance premiums if a first-lien loan.

The additional disclosures discussed above must be equally prominent and in close proximity to the advertised payment or rate that triggered the required disclosures.

Prohibited Advertising Practices. The final rule prohibits a number of advertising practices for dwelling-secured loans deemed to be unfair, deceptive, associated with abusive lending practices, or otherwise not in the borrower's interest. These prohibited practices are:

1. using the term "fixed" when advertising a variable-rate loan or a transaction with a planned payment increase without including information about the time period for which the rate or payment is fixed and stating "ARM," if applicable;
2. comparing the advertised rate or payment to an actual or hypothetical rate or payment without disclosing the rates or payments that will apply during the entire loan's term, and that they do not include taxes and insurance, if applicable;
3. misrepresenting that a loan is government endorsed;
4. using the name of the borrower's current lender without including the actual advertiser's name and disclosing that the current lender is not associated with the advertisement;
5. making a misleading claim that debt will be eliminated or waived rather than replaced;
6. using the term "counselor" to refer to a for-profit mortgage broker or creditor; and
7. providing an advertisement in one language while providing required disclosures in another.

Significant New Open-End Advertising Rules

The final rule also includes new advertising requirements for HELOCs that include promotional rates or promotional payments. Specifically, if a HELOC advertisement includes a promotional rate or a promotional payment amount, the advertisement must include (1) the period of time during which the promotional rate or payment will apply; and (2) information about rates and payments that will apply at the end of the promotional period. A promotional rate is essentially a temporary rate — a rate provided under a variable-rate plan that is not tied to the loan's index and margin used to make later rate adjustments. A promotional payment is one under a variable-rate plan that is not tied to the loan's index and margin for calculating minimum payments. Under a nonvariable-rate plan, a promotional payment is one that is less than required under the plan's terms.

COMPLIANCE MANAGEMENT RECOMMENDATIONS

As with any significant regulatory changes, implementing these changes throughout an institution effectively, thoroughly, and in a timely manner is critical. Identifying how the rule affects your organization and then instituting a plan to implement it are good places to start.

Conduct a Compliance Risk Assessment

The scope of the final rule is broad. It is therefore important to identify all of the areas of operations within an institution that will be affected. Specifically, the institution must assess which bank products or business lines may be subject to the new rule. For instance, what bank departments or offices would originate higher-priced or HOEPA loans? Does the bank advertise mortgages? Do these advertisements include teaser rates or payment amounts?

Next, the institution should identify the specific regulatory requirements that apply to these products or business lines and assess whether the organization currently complies with any of the requirements. For example, an institution may already require escrow accounts for higher-priced, first-lien loans. In that case, bank management should confirm that its procedures comply with those outlined in Regulation Z and, if not, implement appropriate compliance measures for any identified compliance gaps.

Prepare and Implement a Compliance Action Plan

Once an institution has finished assessing its compliance status, it should prepare and implement a plan for updating its compliance management program to address the final rule. The plan should also include methods for monitoring whether internal compliance efforts are working effectively.

Update Policies and Procedures. An important part of complying with the final rule will be updating any affected bank policies and procedures. Changes to policies and procedures should be comprehensive. Such changes could include developing or modifying procedures for:

- properly identifying higher-priced mortgages;
- preventing the origination of higher-priced and HOEPA loans with prohibited terms;
- ensuring that lenders conduct appropriate income verifications on higher-priced and HOEPA loans;
- establishing escrow accounts for all higher-priced, first-lien loans;
- providing early TILA disclosures for all newly covered loans;
- implementing loan servicing practices that ensure timely payment credits and mailing of loan payoff statements; and
- preparing and reviewing mortgage-related advertisements.

An institution's compliance plan should also prepare for the changes to the price reporting provisions of Regulation C. A recent amendment to Regulation C requires modifications to an institution's HMDA data collection and reporting procedures.[10] The amendment makes the threshold for reporting HMDA rate spreads conform to the new definition of higher-priced mortgage loans.

COMPLIANCE STAFF SHOULD PROVIDE THE BOARD OF DIRECTORS AND SENIOR MANAGEMENT WITH A GENERAL SUMMARY OF REGULATION Z'S CHANGES.

Brief the Board of Directors and Senior Management. Compliance staff should provide the board of directors and senior management with a general summary of Regulation Z's changes and explain how the rule will affect the institution's practices and procedures. Staff should also update the board of directors and senior management periodically on efforts within the institution to comply with the new rules.

Conduct Staff Training. Implementing effective and appropriate staff training will be a critical element of the institution's effort to comply with the final rule. Training is most effective when tailored to an individual's job responsibilities and should encompass not only a review of regulatory changes but also new internal bank policies and procedures.

Modify Internal Controls. An institution should evaluate how internal controls can be improved to ensure full compliance with Regulation Z's new requirements. Such controls could include expanded second reviews of higher-priced loans, mortgage-related advertisements, and loan servicing practices. Enhancements to an institution's mortgage processing systems could also help identify covered loans and help prevent improper practices related to such loans. Similarly, an institution may want to conduct periodic tests of its higher-priced and HOEPA loans for compliance with the final rule.

Expand Compliance Audit Coverage. After the institution's compliance plan has been fully implemented, compliance audits should be expanded to include thorough and comprehensive reviews of any new Regulation Z requirements applicable to the bank. In general, the audits should evaluate the effectiveness of the institution's compliance management response to the Regulation Z changes. For instance, has staff training been effective? Have internal controls helped maintain compliance and prevent violations? Have policies and procedures helped provide effective guidance on complying with the final rule?

ADDITIONAL INFORMATION

Additional information about the Regulation Z amendments can be found on the Board's website at http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator.

[10] http://www.federalreserve.gov/newsevents/press/bcreg/20081020b.htm

continued from page 3...

Regulation B and Marital Status Discrimination: Are You in Compliance?

the application. In that circumstance, the bank may be directed to contact all affected borrowers to determine if they, in fact, intended to apply for joint credit.

STANDARDS FOR ADDITIONAL PARTIES

Section 202.7(d)(5) of Regulation B provides that if an applicant does not qualify for individual credit, the bank may require an additional party, such as a co-signer, co-applicant, or guarantor, but may not require that the additional party be the applicant's spouse.[8] Examiners sometimes find violations of this provision. For example, in one instance, examiners determined that loan officers permitted an applicant to have only a spouse as a co-applicant on unsecured consumer loans. Limiting co-applicants to spouses was not required by bank policy, but loan officers imposed this requirement because they did not understand Regulation B. This practice violated §202.7(d)(5). The practice also resulted in nonmarried applicants being treated less favorably than married applicants, in violation of §202.4(a) of Regulation B.

UNDERWRITING

Section 202.6(b)(8) of Regulation B strictly prohibits banks from treating applicants differently based on marital status:

> Except as otherwise permitted or required by law, a creditor shall evaluate married and unmarried applicants by the same standards; and in evaluating joint applicants, a creditor shall not treat applicants differently based on the existence, absence, or likelihood of a marital relationship between the parties.

To ensure compliance with this provision, banks should review underwriting policies and monitor policy exceptions. In one examination, a bank's underwriting of consumer loan applications from married joint applicants differed from its underwriting of unmarried joint applicants. The bank's policy required that joint applicants each meet minimum income and debt-to-income requirements. However, when married applicants applied and failed to meet these requirements, the bank routinely granted exceptions to its policy. In these cases, the loan officers would combine the incomes of the married joint applicants and re-evaluate the application to meet the bank's income and debt-to-income requirements. But the bank did not make exceptions for unmarried co-applicants. The practice of granting underwriting exceptions only for married co-applicants resulted in different standards being applied to joint applicants based on marital status in violation of Regulation B.

GETTING IT RIGHT

As the saying goes, "An ounce of prevention is worth a pound of cure." The same logic applies to avoiding marital status violations. Understanding the details of Regulation B will ensure that banks effectively manage fair lending compliance risk. Lenders should conduct a comprehensive fair lending risk assessment to identify any vulnerabilities in areas in which marital status discrimination could occur. For example, lenders should be especially careful with products for which previous violations have been noted. Lenders should also ensure that all loan officers receive regular training in Regulation B, especially when they move into new product areas. Federal Reserve examiners note that most signature violations are found in commercial or agricultural loans. As a result, banks with large portfolios of such loans should be aware of the fair lending risk associated with those products.

Lenders are also encouraged to implement a compliance process to ensure that the appropriate protocols are being followed. Senior management should periodically assess policies and procedures to ensure that they are properly mitigating fair lending risks at the institution. Effective practices include secondary compliance reviews, strong fair lending training programs, regular internal audits, and clear, unambiguous policies that comply with Regulation B. A comprehensive discussion of all aspects of compliance with these matters is beyond the scope of this article. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator.

[8] §202.7(d)(5).

On the Docket: Recent Federal Court Opinions*

REGULATION Z - TRUTH IN LENDING ACT (TILA)

Seventh Circuit rules that TILA does not allow class actions seeking rescission. *Andrew v. Chevy Chase Bank,* 545 F.3d 570 (7th Cir. 2008). In a significant ruling for lenders, the Seventh Circuit held that the right of rescission under TILA cannot be pursued in a class action. The case represents a reversal of last year's decision by a federal court in Wisconsin. The Wisconsin court made headlines when it certified a class action of borrowers seeking a rescission remedy against Chevy Chase Bank because of Regulation Z violations in the bank's disclosure statement. Lenders were concerned about their exposure to large rescission class action judgments because the $500,000 limit on class action awards in §130 of TILA does not apply to rescission claims. The Seventh Circuit found that it was not plausible that Congress capped damages in class actions at $500,000 to protect lenders from ruinous judgments for technical errors while allowing unlimited class action damages for rescission violations. The court also found that the right of rescission involves many individual issues that cannot easily be adjudicated in the context of a class action.

Right of rescission because of lender's failure to identify payment due date on disclosure statement. *Lippner v. Deutsche Bank National Trust Co.*, 2008 Lexis 14135 (N.D. Ill. Feb. 26, 2008) and *Ware v. Indymac Bank*, FSB, 534 F.Supp2d 835 (N.D. Ill. 2008). The second-quarter issue of *Outlook* discussed *Hamm v. Ameriquest Mortgage Co.*, 506 F.3d 525 (7th Cir. 2007), which held that a lender's failure to state expressly on the TILA disclosure statement that payments were due "monthly" violates §18(g)(1) of Regulation Z. These two cases applied the ruling in *Hamm* to allow borrowers to rescind their loans because the payment period was not identified in their disclosure statements. TILA violations involving "material disclosures" extend the rescission period from three business days up to three years. The payment schedule is a material disclosure under §23(3) of Regulation Z, so rescission was allowed. *Ware* also addressed the argument made by co-defendant CitiMortgage that the claim against it should be dismissed based on its assignee status. The court rejected this argument because the violation was apparent on the face of the disclosure statement.

REGULATION E - ELECTRONIC FUND TRANSFER ACT (EFTA)

Sixth Circuit upholds sufficiency of on-screen ATM fee notice. *Clemmer v. Key Bank,* N.A., 539 F.3d 349 (6th Cir. 2008). In a class action filed against Key Bank, a consumer alleged that the bank violated the EFTA and Regulation E, its implementing regulation, because the bank's ATM fee notice on its screens stated that the bank "may charge a fee" when the bank always imposed a fee on noncustomers. The Sixth Circuit affirmed the dismissal of the case, finding that the use of the phrase "may charge a fee" complied with EFTA and Regulation E because neither the statute nor the regulation prescribes the words that must be used. In addition, the customer was specifically asked, after the fee was disclosed on the ATM screen, whether he wanted to continue with the transaction, and he selected "yes (to accept fee)." This language provided notice that a fee would be imposed, and accordingly, the court affirmed the dismissal of the case.

ARBITRATION CLAUSES

Enforceability of arbitration clause. *Pleasants v. American Express Co*., 541 F.3d 853 (8th Cir. 2008). A consumer sued American Express and American Express Incentive Services (AEIS) because she did not receive TILA disclosures when she purchased a preloaded, stored-value card. The claim against American Express was dismissed because it is not a creditor under TILA. AEIS filed a motion to compel arbitration. The issue for the court was whether an arbitration clause in the consumer's account agreement was enforceable. The plaintiff relied on a Missouri state appellate court decision that struck down an arbitration clause as substantively unconscionable. However, the Eighth Circuit distinguished that case because the clause there prevented the plaintiff from obtaining attorney's fees if she won the lawsuit, which would make a lawsuit very impractical because the amount of attorney's fees to pursue the case would likely exceed the amount of damages. The arbitration clause from AEIS did not place any such limitations on the plaintiff's remedies if she won the lawsuit. The court found this distinction crucial in upholding the arbitration clause.

IDENTITY THEFT

Court dismisses lawsuit alleging increased risk of identity theft. *Kidman v. Wells Fargo & Co*., (N.D. Oh., July 28, 2008). Wells Fargo notified a home mortgage customer that computer disks containing his account information were stolen. The customer responded by filing a class action seeking damages for himself and class members because of their increased risk of identity theft. Significantly, the plaintiff did not allege that he suffered damages because his confidential information had been used improperly. He alleged only that an increased risk of identity theft existed. Wells Fargo filed a motion to dismiss the case, arguing that merely alleging an increased risk of identity theft does not present a cognizable injury and therefore the plaintiff lacked standing to pursue the lawsuit. The court agreed with Wells Fargo and dismissed the case.

FAIR CREDIT REPORTING ACT (FCRA)

FCRA violation to obtain a credit report on behalf of a third party. *Hernandez v. Lamboy Furniture, Inc*., 2008 WL 4061344 (E.D. Pa. Sept. 2, 2008). This case examines violations of §1681b(f) of the FCRA when a user of consumer credit reports obtains a report not for its own permissible purpose but at the request of a third party. Lamboy Furniture, a business with a subscription to a consumer reporting agency, obtained a credit report on Hernandez, a consumer, at the request of Diaz, a Lamboy Furniture customer who claimed to have a permissible purpose but did not, in fact, have one. Hernandez filed suit under §1681b(f) against Diaz, Lamboy Furniture, its principal, and the consumer reporting agency. The court, in deciding a motion for summary judgment, held that Lamboy Furniture and Diaz violated §1681b(f) because they obtained a credit report without a permissible purpose. However, the court held that whether compensatory and punitive damages could be awarded must be decided by a jury because it involved factual and credibility issues about whether the violations were negligent or willful. The court ruled in favor of the reporting agency because it relied on a certification from Lamboy Furniture that it had a permissible purpose in requesting the credit report.

* Links to the court opinions are available in the online version of Consumer Compliance Outlook at http://www.consumercomplianceoutlook.org.

Department of Housing and Urban Development (HUD) Issues Final Real Estate Settlement Procedures Act (RESPA) Rule.
On November 12, 2008, HUD announced a final rule under RESPA to revise the disclosure of key loan terms and closing costs on the good faith estimate (GFE) and the HUD-1/HUD-1a. The revised GFE organizes loan information into tables with subheadings (e.g., "summary of your loan"), while the revised HUD-1 now includes a "loan terms" summary. The final rule also 1) limits charges that can be imposed to deliver the GFE; 2) requires "yield spread premiums" to be included in the disclosed origination charge; 3) expands the definition of "mortgage broker" to include exclusive agents of a lender who provide origination services; 4) amends the definition of "required use" to include incentives for using a particular service provider; and 5) clarifies escrow account requirements and mortgage servicing transfer provisions. Lenders will be required to use the revised forms effective January 1, 2010. The "required use" provision is effective January 16, 2009. HUD's press release, including links to the revised forms, is available at http://www.hud.gov/news/release.cfm?content=pr08-175.cfm.

Board of Governors of the Federal Reserve System (Board) Issues Final Rule to Amend Regulation C to Revise the Definition of Rate Spread.
On October 20, 2008, the Board published its final rule to amend Regulation C, the implementing regulation for the Home Mortgage Disclosure Act (HMDA), to change the definition of a rate spread. Under the current definition, the price of a loan must be reported on the HMDA loan application register if the rate spread — the difference between the price of the loan and the rate for Treasury securities of comparable maturity — exceeds 300 basis points for first-lien loans and 500 basis points for second-lien loans. The final rule changes the definition to match the definition of a higher-priced mortgage loan under the final HOEPA rule, which is discussed beginning on page 1 of this issue. Under HOEPA, a loan is higher priced if its annual percentage rate exceeds by 150 basis points for first-lien loans the average prime offer rate for mortgages of comparable type and 350 basis points for second-lien loans. The Board will publish average prime offer rates on a weekly basis on the Federal Financial Institutions Examination Council's (FFIEC) website. The effective date is October 1, 2009. The Board's announcement is available at http://www.federalreserve.gov/newsevents/press/bcreg/20081020b.htm.

Board Issues Guidance Regarding Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles.
On October 16, 2008, the Board issued a joint supervision letter (SR 08-8/CA 08-11) clarifying certain Federal Reserve supervisory policies regarding compliance risk management programs and oversight at large banking organizations with complex compliance profiles. The letter addresses 1) supervisory policies for firm-wide compliance risk management and oversight programs; 2) compliance staff independence; 3) compliance monitoring and testing; and 4) responsibilities of boards of directors and senior management for compliance risk management and oversight. The joint supervision letter is available at: http://www.federalreserve.gov/boarddocs/srletters/2008/SR0808.htm.

FFIEC Releases 2007 HMDA Data.
On September 10, 2008, the FFIEC released 2007 data for mortgage loan transactions covered by HMDA. The data cover lending activity (applications, originations and denials, and purchases) for 2007, including 21.4 million applications and 4.8 million purchases, for a total of 26.2 million records in 2007. The Board recently published a draft of a forthcoming *Federal Reserve Bulletin* article that analyzes the data. The article is available at http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07draft.pdf.

Federal Housing Finance Agency Publishes "Notice of Establishment."

The Housing and Economic Recovery Act of 2008 created the new Federal Housing Finance Agency (FHFA) to regulate Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. On September 9, 2008, the FHFA published a notice of the "Establishment of a New Independent Agency" in the *Federal Register*. The notice provides formal public notice of the existence of the FHFA, its purpose, and the chapter of the Code of Federal Regulations where its regulations will be codified. The *Federal Register* notice is available at: http://www.ofheo.gov/media/notices/FHFANoticeofEstablishment.pdf.

Board Announces Supervisory Practices Regarding Banking Organizations Affected by the 2008 Hurricane Season.

On September 5, 2008, the Board announced its recommended practices and procedures for customers affected by the 2008 hurricane season. The announcement is available at: http://www.federalreserve.gov/boarddocs/srletters/2008/SR0806.htm.

HUD Adopts Interim Rule Regarding Home Equity Conversion Mortgages (HECMs).

On September 4, 2008, HUD published a final rule to amend its HECM program. The rule extends the date for calculating a maximum HECM claim amount to the date of closing and allows for the eligibility of HECM loans that have been assigned under regulatory provisions and remain in effect, but are not in default, to be refinanced with a discounted initial mortgage insurance premium. The rule became effective on October 6, 2008. The *Federal Register* notice is available at http://edocket.access.gpo.gov/2008/pdf/E8-20471.pdf.

Board Adopts the FFIEC Revised Examination Procedures for Regulation E.

On August 26, 2008, the Board adopted the FFIEC's revised examination procedures for Regulation E. The revisions incorporate amendments to Regulation E made in 2001, 2006, and 2007, including changes to the Official Staff Commentary on electronic check conversion, alternatives to periodic statements for payroll cards, and a new exception for providing receipts at electronic terminals when the amount of the transaction is $15 or less. The Board's announcement is available at http://www.federalreserve.gov/boarddocs/caletters/2008/0807/caltr0807.htm.

Board Adopts the FFIEC Revised Examination Procedures for Regulations M and Z.

On August 26, 2008, the Board adopted the FFIEC's revised examination procedures for Regulations M and Z. The changes concern interim final rules that the Board issued for electronic disclosures under the Electronic Signatures in Global and National Commerce Act (E-Sign Act). The Board's announcement is available at: http://www.federalreserve.gov/boarddocs/caletters/2008/0805/caltr0805.htm.

The Board Adjusts Fee-Based Trigger Under the Truth in Lending Act (TILA) to $583.

On August 5, 2008, the Board announced its annual adjustment to the dollar amount of fees that trigger additional disclosure requirements under Regulation Z for certain home mortgage loans. The new dollar amount has been adjusted to $583 for 2009, effective January 1, 2009. The notice is available at http://www.federalreserve.gov/newsevents/press/bcreg/20080805a.htm.

New Federal Reserve Consumer Mortgage Publication Is Now Available.

The Board published a new consumer publication "A Consumer's Guide to Mortgage Refinancings," which is available on its website. The guide provides comprehensive consumer information about mortgage refinancings. The publication is available at http://www.federalreserve.gov/pubs/refinancings/default.htm.

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Affiliate Marketing Rules

of eligibility information is covered by the notice;
- a general description of the types of eligibility information that may be used;
- the basic rules concerning the opt-out;
- how long the opt-out will be in effect; and
- a disclosure that the consumer does not have to act again until he or she receives a renewal notice, if applicable.

The renewal notice must accurately disclose most of the elements of the original opt-out notice. In addition, it must notify consumers that their previous opt-out is expiring and must include information about the renewal of the opt-out. Each opt-out renewal must be effective for at least five years. The renewal notice must be given by the affiliate that provided the previous opt-out notice or as part of a joint renewal notice from members of an affiliated group of companies that jointly provided the previous opt-out notice. A renewal notice may be provided either a reasonable period of time before the expiration of the opt-out period or any time after the expiration of the opt-out period but before a new solicitation is sent. Further, an opt-out period may not be shortened by sending a renewal notice before the expiration of the opt-out period. The renewal notice may be included in the annual privacy notice required by the Gramm-Leach-Bliley Act.

The renewal notice must accurately disclose most of the elements of the original opt-out notice. In addition, it must notify consumers that their previous opt-out is expiring and must include information about the renewal of the opt-out.

To facilitate compliance, Regulation V contains five model forms that may be used to satisfy the requirements for clear, conspicuous, and concise notices. These forms are available in Appendix C of Regulation V. Use of a model form is not required. A bank may change the language or format of the model forms without losing the protection from liability. However, if the changes are so extensive that they affect the substance, clarity, or meaningful sequence of the language in the model forms, the bank will lose the safe harbor that Appendix C provides. Examples of acceptable changes are also provided in Appendix C.

EXCEPTIONS AND CONSTRUCTIVE SHARING

The initial notice and opt-out requirements for affiliate marketing are subject to exceptions. The requirements do not apply if a bank uses information it receives from an affiliate under any of the following circumstances:

- to make a solicitation for marketing purposes to a consumer with whom the bank has a pre-existing business relationship;
- to facilitate communications to an individual for whose benefit the bank provides employee benefit or other services pursuant to a contract with an employer;
- to perform services on behalf of an affiliate (but this would not allow circumvention of the consumer's opt-out);
- to respond to a communication about the bank's products or services initiated by the consumer; or
- to respond to a consumer's authorization or request to receive solicitations.

Finally, the requirements do not apply if complying with them would prevent the bank from complying with state insurance laws pertaining to unfair discrimination in any state in which the bank lawfully does business.

A bank may use eligibility information received from an affiliate to make solicitations if it was received prior to October 1, 2008, the mandatory compliance date for the affiliate marketing rules. For example, if the information was in a common database prior to October 1, the information may be used for marketing purposes.

The Board's implementing regulations for affiliate marketing, 12 C.F.R. sections 222.20-.28, are available at GPO Access.[4] Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator.

[4] http://www.access.gpo.gov/nara/cfr/waisidx_08/12cfr222_08.html

AFFILIATE MARKETING EXAMINATION PROCEDURES

1. Determine whether the financial institution receives consumer eligibility information from an affiliate. Stop here if it does not because Subpart C of 12 CFR 222 does not apply.

2. Determine whether the financial institution uses consumer eligibility information received from an affiliate to make a solicitation for marketing purposes that is subject to the notice and opt-out requirements. If it does not, stop here.

3. Evaluate the institution's policies, procedures, practices, and internal controls to ensure that, where applicable, the consumer is provided with an appropriate notice, a reasonable opportunity, and a reasonable and simple method to opt out of the institution's using eligibility information to make solicitations for marketing purposes to the consumer, and that the institution is honoring the consumer's opt-outs.

4. If compliance risk management weaknesses or other risks requiring further investigation are noted, obtain and review a sample of notices to ensure technical compliance and a sample of opt-out requests from consumers to determine if the institution is honoring the opt-out requests. Determine whether the opt-out notices are clear, conspicuous, and concise and contain the required information, including the name of the affiliate(s) providing the notice, a general description of the types of eligibility information that may be used to make solicitations to the consumer, and the duration of the opt-out. (12 CFR 222.23(a))

    a. Review opt-out notices that are coordinated and consolidated with any other notice or disclosure that is required under other provisions of law for compliance with the affiliate marketing regulation. (12 CFR 222.23(b))

    b. Determine whether the opt-out notices and renewal notices provide the consumer a reasonable opportunity to opt out and a reasonable and simple method for opting out. (12 CFR 222.24 and .25)

    c. Determine [how] the opt-out notice and renewal notice are provided (by mail, delivery, or electronically) so that a consumer can reasonably be expected to receive the actual notice. (12 CFR 222.26)

    d. Determine whether, after an opt-out period expires, a financial institution provides a consumer with a renewal notice prior to making solicitations based on eligibility information received from an affiliate. (12 CFR 222.27)

Calendar of Events

January 15-16	Regulatory Compliance Institute Mortgage Bankers Association Mortgage Bankers Association Headquarters, Washington, D.C.
February 15-18	National Conference for Community Bankers American Bankers Association JW Marriott Desert Ridge Resort & Spa, Phoenix, AZ
March 9 - 11	2009 Community Reinvestment Act Conference Consumer Bankers Association Omni Shoreham Hotel, Washington, D.C.
March 26	Consumer Advisory Council Meeting Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue NW, Washington, D.C.
March 27 - April 2	National Compliance School American Bankers Association Dolce Hayes Mansion and Conference Center, San Jose, CA

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