CONSUMER COMPLIANCE OUTLOOK

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INSIDE

A FEDERAL RESERVE SYSTEM PUBLICATION WITH A FOCUS ON CONSUMER COMPLIANCE ISSUES

REVERSE MORTGAGES AND CONSUMER PROTECTION ISSUES

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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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HELOCs: Consumer Compliance Implications

By Jason Lew, Examiner, Federal Reserve Bank of San Francisco

Declining home values are becoming an increasingly important issue for both financial institutions and consumers. With home values falling across many markets in the country, many homeowners are experiencing significant declines in the equity in their homes. According to Moody's Economy.com, nearly 8.5 million homeowners have negative or no equity in their homes,[1] representing more than 16 percent of all homeowners with a mortgage. To counter the effects of declining home equity in their loan portfolios, many financial institutions have begun freezing or reducing credit limits on existing home equity lines of credit (HELOCs).

This article will review certain federal regulatory limitations and requirements related to this practice and highlight some consumer compliance concerns that institutions should consider as they contemplate taking this action.

REGULATORY CONSIDERATIONS

When freezing or reducing credit limits on HELOCs, lenders should be cognizant of relevant regulatory limitations and considerations. For example, Regulation Z (Truth in Lending Act) provides specific criteria related to modifying home equity plans. In addition, both Regulation B, which implements the Equal Credit Opportunity Act, and the Fair Housing Act outline general fair lending and other technical requirements that lenders should consider.

Regulation Z[2] allows creditors to freeze or reduce limits on home equity plans in certain circumstances when property values decline. Specifically, the regulation provides that lenders may freeze or reduce the limits of home equity plans when the value of the property that secures the plan declines significantly below the dwelling's appraised value. The commentary to the regulation offers an example of "significant decline": a decrease by 50 percent or more of the difference between the credit limit and the available equity (based on the property's appraised value for purposes of the plan).

For example, assume a home that was originally appraised at $100,000 has a first mortgage balance of $50,000 and a HELOC with a credit limit of $30,000. The difference between the appraised value ($100,000) and the amount of credit outstanding ($50,000 first mortgage and $30,000 HELOC) is $20,000, half of which is $10,000. A lender could prohibit further advances or reduce the credit limit if the value of the property declines from $100,000 to $90,000. While this provision does not require a creditor to obtain an appraisal before suspending credit privileges, a significant decline in value must

[1] Mark Zandi, "U.S. Macro Outlook: Protecting Against the Downside," May 7, 2008. http://www.economy.com/dismal/article_free.asp?cid=104811&src=ce_asp

[2] Section 226.5b(f)(3)(vi)A; see regulation commentary.

occur before suspension can take place. Therefore, if a lender plans to restrict home equity lines, it should ensure that justification for restricting the accounts is adequately documented.

The commentary also indicates that the restrictions on home equity plans are only temporary in nature and that credit privileges must be restored as soon as reasonably possible after the condition that permitted the creditor's action ceases to exist.[3] This latter limitation places an onus on financial institutions to monitor property values on an ongoing basis to ensure that the market conditions that permitted the freeze or reduction still exist. Alternatively, a lender may require the consumer to request reinstatement of the line before it investigates such conditions.[4]

In some instances, freezing or reducing limits on home equity plans may be considered adverse action under Regulation B. Regulation B defines adverse action as, among other factors, an unfavorable change in the terms of an account that does not affect all or substantially all of a class of the creditor's accounts.[5] If the changes under the lender's plan affect only a subset or a smaller portion of the institution's accounts, §202.9(a)(1)(iii) of Regulation B requires the lender to provide an adverse action notification to the affected customers within 30 days of taking such action on their accounts. The content of the adverse action notice must follow the specific rules in the regulation.

LENDERS SHOULD CONSIDER THE FAIR LENDING IMPLICATIONS OF FREEZING OR REDUCING LIMITS ON HELOCs.

In addition to the regulatory requirements noted above, lenders should also consider the fair lending implications of freezing or reducing limits on HELOCs. Both the Equal Credit Opportunity Act and the Fair Housing Act prohibit discrimination in home lending based on certain characteristics, including race, color, and national origin. As a result, before taking action, lenders should consider the fair lending implications of their actions and conduct an analysis of those planned actions for fair lending compliance.

CONCLUSION

Lenders who are considering freezing or reducing credit limits on home equity lines of credit may want to consider the following best practices to ensure compliance with applicable laws and regulations:

- Become familiar with the rules.
- Be sure that staff (i.e., lenders and credit risk managers) are aware of the potential compliance implications of the institution's decisions.
- Have controls in place to ensure that regulatory requirements are being met.
- Be able to support decisions with data.
- Conduct a fair lending assessment of the proposed methodology for freezing or reducing home equity plans. Ensure that the methodology and related policies will be applied consistently. Additionally, analyze potentially affected borrowers and neighborhoods, considering the potential for both disparate treatment and disparate impact. Pay careful attention to potential redlining issues.
- Keep the board of directors apprised with appropriate reporting.

While clearly there are many areas to consider when determining whether to ban additional extensions of credit or to reduce credit limits, this article discussed some aspects of the regulatory requirements in Regulation Z, Regulation B, and the Fair Housing Act, as well as some potential compliance considerations and best practices. In addition to these considerations, as with any changes made to a consumer's account, lenders should clearly communicate them to those affected. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator.

[3] Regulation Z commentary – §226.5b(f)(3)(vi), ¶4

[4] Regulation Z commentary – §226.5b(f)(3)(vi), ¶4

[5] Section 202.2(c)(1) contains additional factors in the definition of adverse action. Section 202.2(c)(2) contains exceptions to the definition.

New Rules Set for Identity Theft Red Flags and Address Discrepancies

By Eddie Valentine, Supervising Examiner, Federal Reserve Bank of Philadelphia

President George W. Bush signed the Fair and Accurate Credit Transactions Act of 2003 (FACT Act) into law on December 4, 2003, in part to combat identity theft, which results in billions of dollars in losses each year to individuals and businesses. Section 114 of the FACT Act directs the federal banking agencies and the Federal Trade Commission (the Agencies) to issue joint regulations and guidelines to address identity theft. In October 2007, the Agencies issued their final rules,[1] which impose the following requirements: 1) financial institutions must implement programs to prevent identity theft; and 2) credit and debit card issuers must develop policies and procedures to identify and resolve address discrepancies for debit and credit card accounts.

In addition, Section 315 of the FACT Act directs the Agencies to issue joint regulations regarding address discrepancies. The Agencies' final rules require users of credit reports to follow specified procedures when they receive a notice from a consumer reporting agency of a substantial difference between a consumer's address that the user provided to request a consumer report and the address in the agency's file. This article summarizes the new rules, for which the mandatory compliance deadline is November 1, 2008.

IDENTITY THEFT PREVENTION PROGRAM

Financial institutions and creditors that offer or maintain covered accounts — which are defined in §222.90(b)(3) of the regulations as all consumer accounts that involve or are designed to permit multiple payments or transactions, and any other accounts (including business purpose accounts) for which there is a reasonable risk of identity theft — must develop and implement a written identity theft prevention program to combat identity theft with respect to new and existing covered accounts. The program must be tailored to the entity's size, its complexity, and the nature of its operations. Each program must satisfy the following requirements:

1. Identify relevant patterns, practices, and specific forms of activity that are red flags[2] signaling possible identity theft and incorporate those red flags into the program;
2. Detect red flags that have been incorporated into the program;
3. Respond appropriately to any red flags that are detected to prevent and mitigate identity theft; and
4. Ensure that the program is updated periodically to reflect changes in risks from identity theft.

BOARD APPROVAL AND OVERSIGHT OF THE IDENTITY THEFT PREVENTION PROGRAM

The regulations also enumerate specific steps that financial institutions and creditors must undertake to administer their programs, including: (1) obtaining approval of the initial written program by the board of directors or a board committee; (2) ensuring oversight to develop, implement, and administer the program; (3) providing adequate training to staff; and (4) providing appropriate oversight of service provider arrangements. Guidelines are included in Appendix J of the regulations to assist financial institutions and creditors in developing and implementing a program that meets the specific requirements of the final rules.

ADDRESS DISCREPANCY RULES FOR ISSUERS OF CREDIT AND DEBIT CARDS

Additionally, credit and debit card issuers must develop policies and procedures to verify a request for a change of address that is followed closely (within 30 days or a longer period established in a creditor's or a financial institution's procedures) by a request for an

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[1] http://edocket.access.gpo.gov/2007/pdf/07-5453.pdf

[2] A red flag is considered a pattern, practice, or specific activity that indicates the possible existence of identity theft. Supplement A to Appendix J of the regulations includes an illustrative list of examples of possible red flags.

additional or replacement card. A card issuer cannot issue the additional or replacement card until it has verified the validity of the change of address request in accordance with the financial institution's policies and procedures. If a change of address request has been verified before a request for an additional or replacement card is received, it is not necessary to verify the address a second time before issuing the card.

ADDRESS DISCREPANCY RULES FOR USERS OF CONSUMER REPORTS

The address discrepancy rules apply to the user of a consumer report that receives notice from a nationwide consumer reporting agency that the address the user included in its request for a report and the address in the nationwide consumer reporting agency's files are substantially different. The rules impose two requirements to establish policies and procedures for responding to address discrepancy notices: one that applies to all users, and another that applies only to users in certain circumstances.

All users must establish reasonable policies and procedures to form a reasonable belief that the consumer whose report the user requested is the same consumer to whom the agency's report pertains. Section 222.82(c)(2) provides examples of acceptable procedures to accomplish this. A user must also develop and implement reasonable policies and procedures for furnishing an address for the consumer that the user has reasonably confirmed is accurate to the consumer reporting agency from which it received the notice of address discrepancy when: 1) the user can form a reasonable belief that the person in the consumer report and the consumer about whom it requested the report are the same person; 2) the user establishes a continuing relationship with the consumer; and 3) the user regularly, in the course of business, furnishes information to the consumer reporting agency that alerted the user to the address discrepancy. Section 222.82(d)(2) provides examples of acceptable ways of verifying a consumer's address.

FINAL THOUGHTS

Financial institutions should have already started to formulate plans for implementing the new rules in anticipation of the November 1, 2008, deadline. In preparing for this deadline, financial institutions should consider the following:

- Setting up a task force to identify covered accounts and relevant red flags for such accounts, and to develop practices and procedures that must be followed when red flags are detected;
- Reviewing the guidelines in Appendix J of the regulations and considering which guidelines to include in your institution's program;
- Allowing sufficient time, prior to the mandatory compliance date, to present proposed identity theft programs to the board of directors for final approval; and
- Staying current on industry developments for any new types of identity theft risks that may affect your organization's customer and account base and adjusting your institution's program accordingly.

In designing its program, a financial institution or creditor may incorporate, as appropriate, its existing policies, procedures, and other arrangements that control reasonably foreseeable risks to customers or to the safety and soundness of the financial institution or to the creditor from identity theft. For example, an institution could include some of the policies and procedures it has established for new accounts under its customer identification program (CIP) required by the Treasury Department's BSA/AML and recordkeeping regulations.

Specific issues and questions about this article should be raised with the consumer compliance contact at your supervising Reserve Bank or with your primary regulator.

> CREDIT AND DEBIT CARD ISSUERS MUST DEVELOP POLICIES AND PROCEDURES TO VERIFY A REQUEST FOR A CHANGE OF ADDRESS THAT IS FOLLOWED CLOSELY BY A REQUEST FOR AN ADDITIONAL OR REPLACEMENT CARD.

GAO Issues Report on Bank Fees

by Kathleen M. Conley, Supervisory Consumer Financial Services Analyst, Federal Reserve Board

As part of a study requested by Congress, employees of the U.S. Government Accountability Office (GAO) recently visited 185 branches of banks, thrifts, and credit unions nationwide to request documents on the fees associated with basic checking and savings accounts. The GAO, an independent agency known as Congress's "watchdog," found that consumers shopping for accounts may find it difficult to obtain account information (fees, terms, and conditions) upon request before opening an account. The GAO reached this conclusion after its employees were unable to obtain a comprehensive list of all checking and savings account fees, when requested, at 40 (22 percent) of the branches visited. The GAO was also unable to obtain the terms and conditions for accounts, including information on when deposited funds became available and how overdrafts were handled, at 61 (33 percent) of the branches

These findings are included in a report issued by the GAO in March 2008. The full report (GAO-08-281), titled "Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts," can be found on the GAO's website.[1]

> According to the GAO report, in 2006 consumers paid over $36 billion in various fees associated with checking and savings accounts at depository institutions.

Study Requested by Congress

According to the GAO report, in 2006 consumers paid over $36 billion in various fees associated with checking and savings accounts at depository institutions. Members of Congress, consumer groups, and others have raised a variety of concerns about these fees, for example, whether depository institutions have increased fees as a source of revenues and, if so, the impact of this trend on consumers. In addition, some questioned how regulators address fee practices in their oversight of depository institutions.

As a result of these concerns, Rep. Carolyn B. Maloney (D-NY), chair of the House Subcommittee on Financial Institutions and Consumer Credit, requested that the GAO conduct a study to examine three things: (1) the trends in the types and amounts of checking and deposit account fees, (2) how banking regulators address such fees in their oversight of depository institutions, and (3) the extent to which consumers are able to obtain information on account fees, terms, and conditions, upon request, prior to opening an account.

GAO Findings

In its study, the GAO found that average fees for some checking and savings account features (such as overdrafts, insufficient funds, returns of deposited items, and stop payment orders) have increased since 2000, while other fees (such as monthly account maintenance fees) have generally declined. For example, the average overdraft fee increased about 11 percent (after an inflation adjustment) between 2000 and 2007. The GAO indicates that changes in both consumer behavior and the practices of depository institutions are likely influencing these trends in fees. Consumers are increasingly using electronic forms of payment that result in rapid or even immediate debits, a development that may mean an increasing number of charges for insufficient funds or overdrafts. Additionally, many depository institutions

[1] http://www.gao.gov/new.items/d08281.pdf

[2] Federal banking regulators address fees associated with checking and savings accounts primarily by examining depository institutions' compliance with the requirements under the Truth in Savings Act (TISA) and Regulation DD, its implementing regulation. Regulators also review consumer complaints. The purpose of Regulation DD is to assist consumers in comparing deposit accounts offered by depository institutions, principally through the disclosures of fees, terms, and conditions whenever a consumer requests the information and before an account is open. Regulation DD requires the disclosures of such account information regardless of whether the consumer requesting the information is an existing or a prospective customer.

have automated overdraft protection programs that have been increasingly marketed to customers.

The GAO also found that interagency examination procedures[2] do not require examiners to verify whether new or potential customers are actually able to obtain the required disclosure documents before opening an account. Nor do the procedures require examiners to assess whether fees are reasonable. Examiners currently focus on reviewing an institution's policies, procedures, and advertisements for compliance with Regulation DD and on reviewing a sample of account disclosure documents for accuracy and completeness as well as for regulatory compliance.

The GAO's finding that its employees did not always receive disclosure information from institutions led the GAO to conclude that while consumers may consider convenience or other factors besides costs when shopping for checking or savings accounts, the inability to obtain information about fees and the conditions under which fees are assessed prior to opening an account "hinders their ability to make meaningful comparisons among institutions."[3]

In addition, the GAO reviewed information from the institutions' websites and found that information on account fees, terms, and conditions was not readily available on the Internet. The GAO recognized that depository institutions are not required to have a comprehensive list of account fees, terms, and conditions on websites if these sites are merely advertising and do not allow consumers to open an account online.

CONGRESS'S REACTION TO GAO FINDINGS

After the release of the GAO study, Rep. Maloney stated in a March 3, 2008, press release: "It's troubling that many consumers may find it difficult to obtain account terms and information about fees before opening an account. You don't have to buy a car before you find out how many miles per gallon it gets, and you don't have to buy a house before you find out what your taxes will be. Why should consumers be forced to walk blindly into the terms and conditions of a bank account? Americans devote a lot of their hard-earned money to bank fees. Many of these fees are for useful services that most consumers are happy to pay for; banks have the right to make money for these valuable services. Problems arise, however, when consumers get smacked with unexpected bank fees – that's just not fair." Rep. Maloney introduced H.R. 946, which is intended to address abusive overdraft fees and equip bank customers with more control and information about overdraft fees.

THE GAO RECOMMENDED THAT THE FEDERAL BANKING REGULATORS, INCLUDING THE FEDERAL RESERVE, STRENGTHEN THEIR BANK EXAMINATIONS TO ENSURE THAT CONSUMERS RECEIVE APPROPRIATE DISCLOSURES FOR ACCOUNT FEES, TERMS, AND CONDITIONS ASSOCIATED WITH DEPOSIT ACCOUNTS PRIOR TO OPENING AN ACCOUNT.

GREATER FOCUS BY EXAMINERS

What do the GAO findings mean for your bank? In its report, the GAO recommended that the federal banking regulators, including the Federal Reserve, strengthen their bank examinations to ensure that consumers receive appropriate disclosures for account fees, terms, and conditions associated with deposit accounts prior to opening an account.

Interagency examination procedures have always included steps to determine whether account disclosures are provided to a consumer upon request. But since the release of the GAO report, banks can expect a greater focus on these requirements by examiners. In fact, the agencies recently issued updated examination procedures with steps for examiners to use that emphasize the existing requirement to provide full account disclosures of fees, terms, and conditions to

[3] GAO Report, p. 7.

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Reverse Mortgages and Consumer Protection Issues

program, homeowners can select from among five payment plans:[4]

- Tenure - equal monthly payments as long as at least one borrower lives and continues to occupy the property as a principal residence.
- Term - equal monthly payments for a fixed period of months selected.
- Line of Credit - unscheduled payments or in installments, at times and in an amount of the borrower's choosing until the line of credit is exhausted.
- Modified Tenure – combines a line of credit and tenure monthly payments.
- Modified Term – combines a line of credit and term monthly payments.

To qualify for a HECM, borrowers must be 62 or older, have paid off their mortgages or have a small balance remaining, and currently live in the home as their primary residence.[5] While the proceeds of a reverse mortgage can be used for any purpose, a recent study by the AARP[6] found that the majority of borrowers surveyed were looking to meet basic needs.

WHAT IS THE POTENTIAL MARKET FOR REVERSE MORTGAGES?

In November 2007, the *Wall Street Journal* noted: "It may sound hard to believe, but one part of the mortgage business is hot: reverse mortgages."[7] Although currently a minor portion of the overall mortgage market (about 1 percent),[8] reverse mortgage lending has been growing exponentially. HECM originations increased from 157 made in fiscal year 1990 to 107,558 in fiscal year 2007.[9] While HECM products account for the overwhelming portion of the reverse mortgage market, an increasing number of lenders have developed proprietary reverse mortgage products that compete with HECM loans. Some of these products are designed to fund mortgages that exceed the maximum loan amount available under the HECM program and give consumers more options, including lower age requirements, more flexible rate structures, and lower fees. Recent growth in private lending programs has likely been stimulated by the prospect of securitization, following the first sale of securities backed by bundled HECM loans to private investors in 2006. While recent credit market disruptions may diminish this prospect in the near term, the initial barrier has been broken.

While the proceeds of a reverse mortgage can be used for any purpose, a recent study by the AARP found that the majority of borrowers surveyed were looking to meet basic needs.

The untapped reverse mortgage market is significant. The NRMLA estimates that as of the first quarter of 2007, seniors age 62 or older had home equity of

[4] http://www.hud.gov/offices/hsg/sfh/hecm/hecmabou.cfm

[5] http://www.hud.gov/offices/hsg/sfh/hecm/hecmabou.cfm

[6] Donald L. Redfoot, Ken Scholen, and S. Kathi Brown, "Reverse Mortgages: Niche Product or Mainstream Solution?" *AARP* (December 2007). http://www.aarp.org/research/credit-debt/mortgages/2007_22_revmortgage.html

[7] Kelly Greene and Valerie Bauerlein, "Reverse Mortgages: The Choices Expand," *Wall Street Journal*, November 13, 2007. http://online.wsj.com/article_email/SB119492066401290839.html

[8] http://www.nrmlaonline.org/rms/press.aspx?article_id=557

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

$4.3 trillion.[10] Considering shifting demographics and home appreciation, the NRMLA suggests that this figure could double within 10 years. Given the potential demand, examiners expect to see many more banks entering the reverse mortgage market as direct originators or as facilitators of broker or correspondent relationships.

PROMOTING INFORMED DECISION-MAKING

Reverse mortgages are a particularly complex type of home loan. The borrower must select from among various products that offer different loan amounts and payment scenarios. Taking out a reverse mortgage involves tapping the equity of a house that typically is owned free and clear. In many cases, this equity represents the borrower's largest single source of net worth. The decision to obtain a reverse mortgage and the process of selecting a product and terms must consider the consumer's life-style, financial situation, and estate plans. The decision should be made in the context of the availability and suitability of other financial products, such as traditional lines of credit. For example, a reverse mortgage may not be the best option because the upfront fees associated with both the HECM and most proprietary products tend to be high. As a result, the reverse mortgage is often an expensive choice for borrowers who plan to remain in their homes for less than three years.

Consumer counseling is mandated for borrowers seeking to obtain a HECM loan. Counselors are responsible for educating borrowers about the financial implications of the transaction and the alternatives that may be available, but they cannot recommend whether a borrower should consummate such a transaction or what loan terms best suit the borrower's situation.[11] Ultimately, the consumer must select a financial option to pursue. For this reason, when crafting marketing strategies for reverse mortgages or working with potential reverse mortgage borrowers, lenders and brokers should not assume that the provision of counseling diminishes in any way the responsibility to provide clear and accurate information about both the benefits and costs of a reverse mortgage.

In this regard, lenders must comply with all legal and regulatory requirements. While reverse mortgages are subject to special rules in §226.33 of Regulation Z (the implementing regulation for the Truth in Lending Act), such loans remain subject to other rules and regulations that apply to mortgage loans, including (but not limited to) other sections of Regulation Z, the Real Estate Settlement Procedures Act, Regulation B (the implementing regulation for the Equal Credit Opportunity Act), and the Fair Housing Act. Lenders and brokers should ensure that marketing materials and direct contact with the consumer reinforce the legally required disclosures and present a consistent message that avoids potentially misleading consumers.

Regarding the marketing of reverse mortgage products, lenders and brokers should be especially sensitive to the prohibition against unfair or deceptive acts or practices under §5 of the Federal Trade Commission Act. Lenders and brokers should avoid presenting the product in a way that misrepresents the product's terms, either affirmatively or by omission, or that is likely to mislead consumers.

To better understand the concept of unfair or deceptive acts or practices, lenders should consult a joint publication issued in 2004 by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation titled "Unfair or Deceptive Acts or Practices by State-Chartered Banks."[12] The statement discusses the management of risks related to unfair or deceptive acts or practices and includes guidance on best practices that state-chartered banks can use to avoid such practices. The statement urges creditors to pay particular attention to ensure that disclosures are clear and accurate with respect to reverse mortgages, as well as other products. Those promoting reverse mortgages should pay particular attention to the following best practices as presented in the agencies' joint statement.

- The need for clear and accurate disclosures that are sensitive to the sophistication of the target audience is heightened for products and services

[10] http://www.nrmlaonline.org/RMS/PRESS.ASPX?article_id=557

[11] http://www.hud.gov/offices/adm/hudclips/handbooks/hsgh/4235.1/42351c2HSGH.pdf

[12] http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040311/attachment.pdf

that have been associated with abusive practices. Accordingly, banks should take particular care in marketing credit and other products and services to the elderly, the financially vulnerable, and customers who are not financially sophisticated. In addition, creditors should pay particular attention to ensure that disclosures are clear and accurate with respect to: the points and other charges that will be financed as part of home-secured loans; the terms and conditions related to insurance offered in connection with loans; loans covered by HOEPA; reverse mortgages; credit cards designed to rehabilitate the credit position of the cardholder; and loans with pre-payment penalties, temporary introductory terms, or terms that are not available as advertised to all consumers.

- Tailor advertisements, promotional materials, disclosures and scripts to take into account the sophistication and experience of the target audience. Do not make claims, representations or statements that mislead members of the target audience about the cost, value, availability, cost savings, benefits, or terms of the product or service.
- Review all promotional materials, marketing scripts, and customer agreements and disclosures to ensure that they fairly and adequately describe the terms, benefits, and material limitations of the product or service being offered, including any related or optional products or services, and that they do not misrepresent such terms either affirmatively or by omission. Ensure that these materials do not use fine print, separate statements or inconspicuous disclosures to correct potentially misleading headlines, and ensure that there is a reasonable factual basis for all representations made.

A higher proportion of the elderly, compared with younger borrowers, may be dealing with health-related issues, resource constraints, or pressing financial matters that compel critical life-style choices, including decisions about the ability to live independently in one's own home. As a result, this target market may be particularly susceptible to being misled by the omission of material product information. Again, although counseling is required for HECM loans (and is recommended as a best practice by the NRMLA for private products), the function of counseling should not be to fill in significant information gaps or correct misunderstandings that may have developed through advertising or other contact with the consumer. For example, the fact that this product is a loan secured by the consumer's dwelling should not be obscured. Many seniors receive benefits from a host of federal programs (Social Security, Medicare, Veterans Administration, Medicaid, etc.). Promoting a reverse mortgage as a federally sponsored "benefit" might obscure the fact that it is a loan with significant associated cost and could mislead some borrowers about the true nature of the product.

Marketing of reverse mortgages that emphasizes the amount of money that can be borrowed or that payments need not be made during the term of the loan to the exclusion of communicating the significant costs associated with obtaining the mortgage could adversely affect the prospective borrower's capacity to make informed decisions later in the process, even after cost information has been disclosed. Web-based reverse mortgage calculators, for example, that compare only the features of different products, but not the associated or relative costs, might create a bias toward a particular product that could prove difficult to overcome, even after the consumer has received more detailed information and counseling.

> PROMOTING A REVERSE MORTGAGE AS A FEDERALLY SPONSORED "BENEFIT" MIGHT OBSCURE THE FACT THAT IT IS A LOAN WITH SIGNIFICANT ASSOCIATED COST AND COULD MISLEAD SOME BORROWERS ABOUT THE TRUE NATURE OF THE PRODUCT.

EVOLVING CONSUMER PROTECTION ISSUES

Over the years, both Congress and HUD have been sensitive to potential abuse in the reverse mortgage market. For example, in 1999, HUD implemented rules that effectively banned the payment of referral fees under the guise of estate planning, financial advice, and other services that are related to the mortgage but are not required to obtain a HECM loan.[13]

More recently, another potential concern has come to light. The AARP study raised the specter of unscrupulous reverse mortgage lenders' extending such loans in conjunction with ill-suited financial products. Nine percent of borrowers surveyed by the AARP said that their lenders had offered them specific financial products – including annuities and long-term care insurance – that may be unwise investments relative to loan costs.[14] These concerns were the focus of testimony at a hearing held by the U.S. Senate Special Committee on Aging on December 12, 2007.[15]

Where to Find Information on Reverse Mortgages

Information on reverse mortgages is available from a number of reputable organizations. The following websites provide additional information on this topic, and several were used as resources for this article.*

AARP
www.aarp.org/money/revmort

Fannie Mae
www.fanniemae.com/global/pdf/homebuyers/moneyfromhome.pdf

National Council on Aging
www.ncoa.org/content.cfm?sectionID=321&detail=1795

National Reverse Mortgage Lenders Association
www.reversemortgage.org

Department of Housing and Urban Development
www.hud.gov/offices/hsg/sfh/hecm/hecmhome.cfm

* The Kaplan article provided these resources, some of which have been updated. http://www.stlouisfed.org/publications/br/2008/a/pages/1-article.html

This testimony in conjunction with findings from the AARP study suggests potential conflicts of interest that might lead to abuse in the reverse mortgage market. Reinforcing this concern is the finding in the AARP's study that most consumers do not know much about reverse mortgages and have many misconceptions.[16] It is therefore important that lenders and others in the reverse mortgage market ensure that all communications regarding this product are both clear and accurate.

Consumer complaint and inquiry data collected by the Federal Reserve System reinforce this conclusion. A review of these data suggests that while reverse mortgages account for a relatively small percentage of the total, the 18 complaints and inquiries received through April 2008 already exceed the total number received for the previous two years. It is possible that this increase merely reflects the growing volume of such lending, the promotion of such loans, or heightened consumer interest in such loans, but the increased evidence could also reflect consumer confusion about a complex product.

CONCLUSION

Whether a direct originator, a broker, or a correspondent, those involved in the reverse mortgage business should be particularly mindful of the legal and reputational risks of engaging in, or becoming associated with, acts or practices that could be considered unfair or deceptive. Market participants should take actions that promote informed decision-making.

[13] http://www.hud.gov/offices/adm/hudclips/letters/mortgageefiles/99-2ml.doc

[14] http://assets.aarp.org/rgcenter/consume/2007_22_revmortgage.pdf at pp 89-90

[15] http://aging.senate.gov/minority/index.cfm?Fuseaction=Hearings.Detail&HearingID=9a59e516-2933-4c2e-b91d-bb01336bd016

[16] http://assets.aarp.org/rgcenter/consume/2007_22_revmortgage.pdf; see pp. 107-08

continued from page 7...

GAO Issues Report on Bank Fees

a consumer, upon request, regardless of whether the consumer is an existing or a prospective customer.

COMPLIANCE TIPS FOR BANKS

What can your institution do to ensure it complies with Regulation DD? Train, maintain, and retain:

- Train all appropriate employees, at all branches and offices, on the requirement to provide full account disclosure (e.g., fees, terms, and conditions) to a consumer, upon request, regardless of whether the consumer is an existing or a prospective customer. The disclosures should be provided to the consumer at the time of the request if the consumer makes the request in person or within 10 days if the consumer is not present when making the request (e.g., a telephone request).
- Maintain a file containing a comprehensive list of all checking and savings account fees so that employees have the information readily available to provide to consumers. The file should also contain complete information on account terms and conditions for checking and savings accounts.
- Retain evidence of compliance with Regulation DD, including the requirement to provide consumer disclosures upon request. For example, banks could retain samples of all checking and savings account fee disclosures.

FINAL THOUGHTS

The GAO concludes its report by emphasizing the importance to consumers of effective account disclosures as they shop for deposit accounts in the current environment of upward trending fees. As a result of the GAO's findings, banks can expect questions from examiners on how banks ensure that consumers receive disclosure information from bank employees when requested.

Consumer Compliance Outlook

Third Quarter 2008

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A federal reserve system publication with a focus on consumer compliance issues

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

continued on page 8

[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

Federal Reserve Consumer Help

In October 2007, the Federal Reserve System implemented Federal Reserve Consumer Help (FRCH) to centralize support for consumers with banking questions or concerns. To simplify the process for consumers, FRCH accepts questions about any financial institution and then forwards the question to the appropriate banking agency for resolution. Complaints about state member banks, which are supervised by the Federal Reserve, are investigated by the regional Reserve Banks.

The Federal Reserve System considers consumer complaints an important facet of its overall consumer compliance program. The information contained in complaints can be used by consumer examiners to scope examinations, to inform rule writing, and to generally understand the problems consumers face when dealing with banks. Information from consumer complaints helped form some of the provisions of the unfair or deceptive acts and practices rules recently proposed by the Board of Governors.*

FRCH provides a single point of entry to help consumers access relevant information or navigate to the appropriate agency if they wish to file a complaint. FRCH staff is accessible via toll-free telephone and fax numbers, TTY for the hearing impaired, e-mail, or an online complaint form. In the first six months of operation, FRCH received inquiries from almost 14,000 consumers.

The FRCH implementation included developing a website that gives consumers easy access to the Federal Reserve for information about consumer protection issues. A key site feature is the frequently asked questions (FAQ) section. Questions are ranked by how often they are accessed by website visitors, and new questions are added to the site based on FRCH's interactions with consumers.

From the standpoint of items to watch, the most frequently accessed questions at present are: "Can a bank really post withdrawals from my account from the largest dollar amount to the smallest?" and "Can a bank really keep adding new fees to my account?"

In the first six months of FRCH operations, the most common questions it received involved credit card and deposit products. Consumer concerns included credit solicitations and adverse action notice counter-offers received from banks pursuant to solicitations. Deposit account concerns largely involved how and why overdraft and insufficient funds fees were assessed. In addition, consumers had questions concerning bank policies for opening and closing both deposit and credit accounts.

FRCH's experience to date reinforces the idea that good customer service must include consumer education. Effectively responding to customers' information needs may prevent confusion on the part of the consumer, confusion that can lead to formal complaints about a bank. Bank staff may find the FAQ on the FRCH website a helpful reference for identifying frequently misunderstood banking practices.

For more information, visit www.FederalReserveConsumerHelp.gov.

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* The proposed rules are discussed in News from Washinton on p. 17.

On the Docket: recent federal court opinions*

REGULATION Z – TRUTH IN LENDING ACT (TILA)

Right of rescission. *McMillian v. AMC Mortgage Services, Inc.,* 2008 U.S. Dist. Lexis 45519 (S.D. Ala. June 10, 2008). The plaintiffs sought to rescind their mortgage loan more than three years after the closing date based on a technical violation of TILA in the rescission notice. The defendant moved to dismiss based on TILA's statute of limitations. The court had to decide whether the rescission period was suspended because of a pending class action against the lender and whether the loan was subject to TILA's three-day or three-year rescission period. The court refused to suspend the statute of limitations because the three-year period for rescission claims in §1635(f) of TILA cannot be suspended under the Supreme Court's decision in *Beach v. Ocwen Federal Bank*, 523 U.S. 410, 419 (1998). The court also held that the borrowers were subject to a three-day rescission period. The borrowers argued that the three-year period applied because the rescission notice contained errors by referencing a "one week cancellation period" and by failing to identify the last date on which the borrowers could rescind. However, the court rejected these arguments because, in the Eleventh Circuit, the three-day period is not enlarged as long as the lender provides a "clear and conspicuous notice of rescission." Because the lender's notice conspicuously stated that the borrower had "THREE BUSINESS DAYS" to rescind, the rescission notice was sufficient.

REGULATION X – REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

RESPA does not cover markup claim for excessive fees. *Friedman v. Mortgage Street Mortgage Corporation*, 520 F.3d 1289 (11th Cir. 2008). The Eleventh Circuit joins the Second, Third, Fourth, Seventh, and Eighth circuits in holding that RESPA does not permit a claim that a settlement service fee is excessive relative to the services provided because RESPA is not a price-control statute. This case concerns a class action challenging an escrow waiver fee, which the lender imposed on borrowers who opted out of the escrow for taxes and property insurance. The trial court, after a prior appeal and remand, certified a class action under §8(b) of RESPA of borrowers who had paid the fee. The lender appealed, arguing that RESPA does not apply to an excessive fee claim. The Eleventh Circuit agreed with the lender, concluding that the language of §8(b) specifically prohibits charging a fee when no services are performed but does not regulate the amount of a fee when services are provided.

FAIR LENDING: REGULATION B (EQUAL CREDIT OPPORTUNITY ACT) AND FAIR HOUSING ACT

Court dismisses redlining claim. *JAT, Inc. v. National City Bank of the Midwest,* 2008 U.S. Dist. Lexis 45059 (E.D. Mich. June 10, 2008). Several churches with predominantly minority congregations and several minority-owned businesses joined together to sue the National City Bank of the Midwest, alleging that the bank had a policy of redlining African-American commercial borrowers in the city of Detroit, in violation of the Equal Credit Opportunity Act, the Fair Housing Act, and the Civil Rights Act of 1866 and 1870. The bank moved to dismiss the case. In reviewing the legal framework for analyzing this claim under these statutes, the court identified a plaintiff's initial burden of proof to establish a prima facie case of discrimination based on circumstantial evidence. Each plaintiff must establish that: 1) it is a member of a protected class; 2) it applied for and was qualified for a loan; 3) the loan application was rejected despite its qualifications; and 4) the lender continued to approve loans for applicants with qualifications similar to those of the plaintiff. The court reviewed each of the plaintiff's claims and concluded that all failed to establish the fourth requirement, namely, that the lender continued to approve loans for applicants with similar qualifications. As a result, the court dismissed the case. The court also refused to hear expert testimony to show that the lender engaged in a pattern or practice of discrimination because that type of evidence is limited to government cases and class actions. The docket indicates that the plaintiffs have appealed to the U.S. Court of Appeals for the Sixth Circuit.

FAIR CREDIT REPORTING ACT (FCRA)

Fourth Circuit affirms punitive damages award against furnisher of credit information for failing to notify consumer reporting agencies that consumer disputed a debt. *Saunders v. Branch Banking & Trust Co. of Virginia*, (4th Cir. 2008). The Branch Banking & Trust Co. of Virginia (BB&T) appealed a jury verdict of $81,000 in punitive and statutory damages for violating §1681s-2(b)(1) of the FCRA. BB&T obtained a consumer car loan from a dealer but failed to book it in its system and provide the borrower with a payment book to repay it. The borrower contacted BB&T to request repayment information, but BB&T employees repeatedly said no amount was due. BB&T finally recorded the loan eight months later and notified the borrower that he was in default and accelerated the balance due. BB&T said it would reinstate the loan if the consumer paid late fees and penalties. When the borrower refused, BB&T repossessed the car and reported it to the consumer reporting agencies. The borrower disputed BB&T's debt with TransUnion, which triggered BB&T's duty to investigate the debt and report if the information was incomplete or inaccurate. The Fourth Circuit found that BB&T violated the FCRA by failing to note the consumer's ongoing dispute about the debt. BB&T also challenged the amount of punitive damages, arguing that the ratio of $80,000 in punitive damages to the $1,000 in statutory damages was unconstitutional under *State Farm Mutual Auto Ins. Co. v. Campbell,* 538 U.S. 408 (2003). But the Fourth Circuit held that a challenge to a punitive damage based on a large ratio is not valid when, as here, a jury awards a small amount of nominal damages. The court examined punitive damages in other FCRA cases and found that $80,000 was consistent with the awards in those cases.

The First, Seventh, and Eighth circuits significantly narrow claims for "firm offer of credit." *Sullivan v. Greenwood Credit Union*, 520 F.3d 70 (1st Cir. 2008), *Dixon v. Shamrock Financial Corporation*, 522 F.3d 76 (1st Cir. 2008), *Murray v. New Cingular Wireless Services, Inc*. 523 F.3d 719 (7th Cir. 2008), and *Poehl v. Countrywide Home Loans, Inc.*, 528 F.3d 1093, 2008 WL 2445966 (8th Cir. June 19, 2008). Under the FCRA, creditors cannot access consumer credit reports without consent unless an exception applies. One exception is for a "firm offer of credit" under §1681b(c)(1)(B) of the FCRA, which allows a creditor to engage the consumer reporting agencies to identify consumers who meet a specified credit profile based on information in their credit reports (a process known as prescreening). As a condition for prescreening, §1681b(c)(1)(B) requires that creditors make a firm offer of credit to all consumers who meet the criteria specified. Many creditors became concerned about liability under this section after the Seventh Circuit's decision in *Cole v. U.S. Capital, Inc.*, 389 F.3d 719 (7th Cir. 2004), which held that a firm offer of credit "must have sufficient value for the consumer to justify the absence of the statutory protection of his privacy." *Cole* spawned numerous "firm offer of credit" class actions. However, these new decisions significantly limit *Cole's* scope and will make it difficult to file lawsuits alleging a credit offer is invalid because it lacks value or fails to include all necessary credit terms. Murray rejected the plaintiffs' argument that a firm offer of credit must have "value." *Murray* limited *Cole's* value requirement to its facts, where the creditor was accessing credit report information to sell merchandise (which the FCRA does not permit). *Murray* further clarified that in a pure offer of credit, where the sale of merchandise is not involved, the FCRA requires only that the offer be "firm," not that it have "value." The court also addressed whether a credit offer must contain all material terms and concluded that the FCRA does not impose this requirement. The decisions in *Sullivan*, *Dixon*, and *Poehl* reached similar conclusions.

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* Links to the court opinions are available in the electronic version of *Consumer Compliance Outlook* at http://www.philadelphiafed.org/src/consumer-compliance/index.cfm

News From Washington

Board Issues Final Consumer Mortgage Rules Under HOEPA.[1]

On July 14, 2008, the Board of Governors of the Federal Reserve System (Board) issued its final rules under Regulation Z for consumer mortgages and advertising using its rulemaking authority under the Home Ownership Equity Protection Act of 1994 (HOEPA) and the Truth in Lending Act. The mortgage rules fall into two categories: three rules that apply to all closed-end mortgages secured by a consumer's principal dwelling, and four rules that apply only to a new category of loans known as "higher-priced mortgage loans" (HPML) based on the annual percentage rate of the loan and designed to capture all subprime mortgages. The rules take effect on October 1, 2009, except that the effective date for the new escrow requirement for HPMLs is April 1, 2010, for site-built homes and October 1, 2010, for manufactured homes. The new advertising rules under Regulation Z require additional information about certain loan features and ban seven misleading advertising practices. Finally, the Board also proposed amendments to Regulation C (the Home Mortgage Disclosure Act) to change the definition of "higher-priced loans" so that it conforms to the definition of HPMLs under the new HOEPA rules. The rules will be discussed in detail in a future issue of *Consumer Compliance Outlook*.

Agencies Publish 2008 Host State Loan-to-Deposit Ratios.[2]

On June 26, 2008, the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) made public the 2008 host state loan-to-deposit ratios that the agencies use for verifying compliance with §109 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 during a bank's Community Reinvestment Act examination. Section 109 prohibits a bank from establishing or acquiring a branch outside its home state when the primary purpose is to acquire deposits. A bank complies with §109 if the loan-to-deposit ratio in its home state is at least one-half the loan-to-deposit ratio of the host state where it plans to establish or acquire a branch. If the home state ratio is less than one-half the host state ratio, a second test is conducted to determine whether the bank is reasonably meeting the credit needs of the communities of the interstate branches. If the bank fails the second test, it violates §109 and can be sanctioned by its regulator.

Agencies Publish Final Illustrations for Hybrid Adjustable-Rate Mortgage Products.[3]

On May 30, 2008, the Board, the FDIC, the OCC, the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) issued the final illustrations for certain hybrid adjustable-rate mortgage (ARM) products. The illustrations are designed to help consumers understand how ARM products compare to a fixed-rate mortgage by displaying a comparison chart of the monthly payments for a 30-year ARM product (using three hypothetical changes in the annual percentage rate during the life of the loan) and a 30-year fixed-rate product. Banks are not required to use the illustrations.

Agencies Publish 2008 List of Distressed or Underserved Nonmetropolitan Middle-Income Geographies.[4]

On May 30, 2008, the Board, the FDIC, the OCC, and the OTS issued the 2008 list of distressed or underserved nonmetropolitan middle-income geographies. Bank activities to revitalize or stabilize any of the designated areas will receive CRA consideration as "community development." The information can be downloaded in Adobe PDF or Excel spreadsheet formats.

Agencies Propose Rules on Risk-Based Pricing Notices.[5]

On May 8, 2008, the Board and the Federal Trade Commission (FTC) issued for public comment proposed rules regarding risk-based pricing notices (notice). The rulemaking was required by §311 of the Fair and Accurate Credit Transactions Act of 2003. The proposed rules require a creditor to send a notice to a consumer when the creditor uses a credit report in evaluating a consumer credit application and offers terms materially less favorable than the most favorable terms available to a substantial proportion of consumers, based in whole or part on information in the report. The notice would have to

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

[2] http://www.federalreserve.gov/newsevents/press/bcreg/20080626a.htm

[3] http://www.federalreserve.gov/newsevents/press/bcreg/20080522a.htm

[4] http://www.ffiec.gov/cra/examinations.htm#UDGEO

[5] http://www.federalreserve.gov/newsevents/press/bcreg/20080508a.htm

include all of the disclosures required by §615(h)(5) of the Fair Credit Reporting Act (FCRA) as well as a statement that the terms offered to the consumer may be less favorable than the terms offered to consumers with better credit histories. Consumers receiving a notice must also be told that they can obtain a copy of their credit report without charge. If the creditor will be sending the consumer an adverse action notice under §615(b) of the FCRA, a risk-based pricing notice is not required. The purpose of this disclosure is to encourage consumers to review their credit reports for inaccuracies. The proposal generally requires that the notice be provided to the consumer after the terms of credit have been set but before the consumer becomes contractually obligated on the credit transaction. The closing date for comments was August 18, 2008.

Agencies Propose Rules for Credit Cards and Overdraft Services.[6]

On May 2, 2008, the Board, the OTS, and the NCUA jointly issued proposed regulations to ban unfair credit card practices and deposit account overdraft services using their authority under §5 of the FTC Act to prohibit unfair or deceptive acts or practices. For credit cards, the proposal would 1) prohibit financial institutions from increasing the APR of an outstanding card balance (with limited exceptions, including not receiving a payment within 30 days of the due date); 2) regulate payment allocation when consumers send payments in excess of the minimum payment and have multiple balances with different APRs so that financial institutions could not always allocate the entire payment to the balance with the lowest APR; 3) allow consumers to take full advantage of promotional rates on card offers (such as 0 percent APR balance transfer offers for a limited period of time) by requiring that payments in excess of the minimum be applied to nonpromotional rate balances first; 4) prohibit financial institutions from imposing late fees unless they provide a reasonable amount of time to pay a balance (with a safe harbor of at least 21 days provided between the mailing of the periodic statement and the due date for the payment); 5) prohibit financial institutions from using the double-cycle (or two-cycle) balance computation method, where the balance is computed by averaging the balance from the current and last billing cycle rather than just the current one; 6) prohibit financial institutions from imposing an over-the-credit-limit fee if it results solely from a credit card hold; 7) prohibit financial institutions from financing credit availability fees if such fees exceed 50 percent of the credit line; and 8) require that, for firm offers of credit under the FCRA, the creditor disclose the factors that determine if a consumer will qualify for the most favorable APR and credit limit. For overdraft services, the proposal would 1) prohibit financial institutions from imposing overdraft fees if they result solely from a debit card hold; and 2) require that institutions offer consumers the opportunity to opt out of overdraft programs. The closing date for comments was August 4, 2008.

Board Proposes New Disclosures for Overdraft Services Under Regulation DD.[7]

On May 2, 2008, the Board issued proposed amendments to Regulation DD regarding new disclosure requirements for deposit account overdraft services. The proposal complements the Board's rulemaking for overdraft services discussed above. The proposed rules would 1) require financial institutions to disclose the aggregate costs of overdraft services on periodic statements (the amount of fees incurred in the current statement and the cumulative amount of fees for the year to date); and 2) prohibit financial institutions from including the amount of overdraft protection when displaying an account balance for the deposit account. Banks would be permitted to provide a second balance that includes the amount of overdraft protection available on the account if it is prominently disclosed along with the actual balance information. The closing date for comments was July 18, 2008.

Board Proposes Amendments to Regulation Z.[8]

On May 2, 2008, the Board issued proposed amendments to Regulation Z. This proposal is intended to complement the Board's regulation on unfair rulemaking discussed above. Under the proposal, 1) creditors could not require that mailed payments be received earlier than 5:00 p.m. on the due date; 2) consumers could reject a subprime card with substantial fees after account opening (but before using the card) and avoid the fees; 3) creditors publishing advertisements for deferred interest plans stating "no interest" (or similar) would have to prominently disclose

[6] http://www.federalreserve.gov/newsevents/press/bcreg/20080502a.htm

[7] http://www.federalreserve.gov/newsevents/press/bcreg/20080502a.htm

[8] http://www.federalreserve.gov/newsevents/press/bcreg/20080502a.htm

the circumstances when interest can be charged; and 4) creditors would be prohibited from substituting a new general-purpose credit card for an existing single-merchant card without the consumer's consent if the existing card has been "inactive" for 24 months or longer. The closing date for comments was July 18, 2008.

Board Creates Subprime Mortgage Condition Maps.[9]
On April 1, 2008, the Board announced that the Federal Reserve System was making available color-coded maps and data that illustrate subprime and alt-A mortgage loan conditions across the United States. The maps, which are maintained by the Federal Reserve Bank of New York, will display regional variations in the condition of securitized owner-occupied subprime and alt-A mortgage loans. The maps and data can be used to assist in identifying existing and potential foreclosure hotspots. The maps are available at www.newyorkfed.org/mortgagemaps/.

Interagency Examination Procedures for the Talent Amendment[10]
The Task Force on Consumer Compliance of the Federal Financial Institutions Examination Council (FFIEC) approved interagency examination procedures to verify compliance with the Department of Defense's (DoD) implementing regulations for the John Warner National Defense Authorization Act for Fiscal Year 2007 (known as the Talent Amendment), regarding limitations on consumer credit extended to service members and dependents. The DoD rule, which is codified at 12 C.F.R. 232, covers payday loans, motor vehicle title loans, and tax refund anticipation loans and applies to all persons engaged in the business of extending such credit and their assignees. The DoD rule limits the amount a creditor can charge service members and their dependents for a covered transaction. Total charges must be expressed as a total dollar amount and as an annualized rate called the military annual percentage rate, or MAPR, which may not exceed 36 percent. The rule applies to consumer credit extended to a covered borrower and consummated on or after October 1, 2007. The examination procedures identify four objectives: 1) determine an institution's compliance with the regulations; 2) assess the quality of the institution's compliance risk management systems and policies and procedures for implementing the provisions; 3) determine the reliance that can be placed on the institution's internal controls and procedures for monitoring the institution's compliance with the provisions; and 4) determine corrective action when violations of the regulations are identified or when the institution's policies or internal controls are deficient. The examination procedures are available on the Board's website.

Updated Interagency Examination Procedures for Regulation DD[12]
The Task Force on Consumer Compliance of the FFIEC approved updated interagency examination procedures for Regulation DD, the implementing regulation for the Truth in Savings Act. The updated procedures: 1) incorporate the Board's amendments to the regulation and official staff commentary regarding electronic disclosures; and 2) respond to recommendations made by the Government Accountability Office (GAO) in its March 2008 study "Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts"(GAO-08-281).[11] The examination procedures contain language supplementing current procedures to emphasize the existing requirement to provide full account disclosure (e.g., fees, terms, and conditions) to a consumer upon request, regardless of whether the consumer is an existing or prospective customer. The revised procedures also remind examiners that institutions must maintain evidence of compliance with Regulation DD, including the requirement to provide consumer disclosures upon request. Finally, the revised procedures focus on the need for examiners to make sure that supervised institutions train appropriate employees in these disclosure requirements of Regulation DD. The revised procedures are available on the Board's website. An article discussing the GAO study appears on page 6.

[9] http://www.federalreserve.gov/newsevents/press/other/20080401a.htm

[10] http://www.federalreserve.gov/boarddocs/caletters/2008/0804/caltr0804.htm

[11] http://www.gao.gov/new.items/d08281.pdf

[12] http://www.federalreserve.gov/boarddocs/caletters/2008/0803/caltr0803.htm

Consumer Compliance Resources

Listed below are important compliance resources for financial institutions. A more comprehensive list of resources is available at: http://www.consumercomplianceoutlook.org.

RESOURCE	DESCRIPTION
Overall Consumer Compliance	
Federal Reserve's Consumer Compliance Handbook	Manual used to conduct compliance examinations of state member banks
Federal Reserve Board's Regulations	Compilation of the Board's regulations
Federal Reserve Board's Consumer Affairs Letters	Letters addressing policy and procedural matters related to Federal Reserve System's consumer compliance supervisory responsibilities
Fair Lending and Equal Credit Opportunity Act (ECOA) — Regulation B	
Interagency Fair Lending Examination Procedures	Procedures used for conducting fair lending examinations
Justice Department's Fair Lending/Fair Housing Resource Page	Collection of fair housing and fair lending resources from the Justice Department
HUD's Fair Lending Page	Collection of fair lending resources from HUD
Banker's Guide to Risk-Based Fair Lending Examinations	Overview of the interagency fair lending examination procedures from the Federal Reserve Bank of Chicago
Home Mortgage Disclosure Act (HMDA) — Regulation C	
FFIEC HMDA Resource Page	Collection of HMDA resources
HMDA Getting It Right	Guide to recording and reporting HMDA data
FFIEC Geo-Coding Page	Web-based geo-coding system
Flood Insurance — Regulation H	
FEMA's Mandatory Purchase of Flood Insurance Guidelines	FEMA requirements when purchasing flood insurance
FEMA's Flood Manual	FEMA's in-depth guidance for flood insurance
FEMA's Flood Insurance Regulation	FEMA's regulation about flood insurance coverage and rates
Floodsmart: FEMA's Flood Purchase Page	Information about FEMA's flood insurance program
National Flood Insurance Act of 1968 and Flood Disaster Protection Act of 1973	Text of the two flood insurance statutes
Real Estate Settlement Procedures Act (RESPA) — Regulation X	
HUD's RESPA Page	Collection of RESPA resources
Truth in Lending Act — Regulation Z	
OCC APR Calculator	Software to verify annual percentage rates
Community Reinvestment Act (CRA) — Regulation BB	
FFIEC CRA Resource Page	Collection of CRA resources
CRA Interagency Questions & Answers	Frequently asked questions about the Community Reinvestment Act
CRA Examinations	Collection of resources for CRA examinations from the FFIEC
Truth in Savings Act (TISA) — Regulation DD	
OCC APY Calculator	Software to verify annual percentage yields
Payment Cards Center	
Payment Cards Center	Collection of resources for payment card issues
Fair Credit Reporting Act (FCRA)	
FTC Fair Credit Reporting Act Page	Collection of FCRA resources
Electronic Banking	
FFIEC Guidance on Electronic Financial Services and Consumer Compliance	Guide to compliance issues for electronic banking

Calendar of Events

September 25	Debt Settlement Workshop Federal Trade Commission, Satellite Building Conference Center 601 New Jersey Avenue, NW, Washington, DC
October 2	Examining Successful Collaborations & Ongoing Barriers to Foreclosure Prevention Federal Reserve Bank of Chicago, University of Wisconsin Extension and the Wisconsin Housing and Economic Development Authority County Springs Hotel - Waukesha, WI
October 16	Saving the American Dream: Preventing Foreclosures and Preserving Homeownership Federal Reserve Bank of Chicago, Detroit Branch 1600 East Warren Avenue, Detroit, MI
October 23	Consumer Advisory Council Meeting Board of Governors of the Federal Reserve System, Martin Building 20th and C Streets, NW, Washington, DC
October 24-30	National Compliance School American Bankers Association Wyndham Lisle-Chicago Hotel, Lisle, IL

Consumer Compliance Outlook

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RETURN SERVICE REQUESTED