

CONSUMER COMPLIANCE OUTLOOK®

FIRST QUARTER 2012
INSIDE

View from the Field: Commonly Cited Compliance Violations in 2011.....	2
Risk-Based Pricing Notice Requirements: Questions and Answers.....	4
News from Washington	6
On the Docket	8
Compliance Alert.....	17
Index of Articles	18
Calendar of Events	20

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



Smartphone interactive scan

FAIR LENDING WEBINAR QUESTIONS AND ANSWERS*

BY MAUREEN YAP, SPECIAL COUNSEL/MANAGER, FAIR LENDING ENFORCEMENT SECTION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

On November 2, 2011, the Board of Governors of the Federal Reserve System (Board), on behalf of the Non-Discrimination Working Group of the Financial Fraud Enforcement Task Force, conducted an *Outlook Live* webinar titled "Fair Lending Issues and Hot Topics."¹ Participants submitted a significant number of questions before and during the session. Because of time constraints, only a limited number of questions were answered during the webcast. This article addresses the most frequently asked questions.

FAIR LENDING EXAMINATIONS

1. What efforts is the Board undertaking to improve the efficiency of the fair lending examination process?

The Board supervises approximately 800 state member banks, and fair lending is a critical component of the consumer compliance supervision process. We understand that many banks, particularly smaller banks, may find fair lending to be a challenging part of the examination. We have taken several steps to address this concern.

In 2009, in conjunction with the other federal banking agencies, the Board revised the Interagency Fair Lending Examination Procedures to provide more detailed information regarding current fair lending risk factors and to ensure that our examination procedures kept pace with industry changes. The procedures are available to any bank to aid in its analysis of fair lending risks and to prepare for fair lending examinations.²

CONTINUED ON PAGE 10

* The views expressed are those of Board staff and do not necessarily reflect the views of the Board or the other federal agencies that participated in the webinar.

¹ An archived version of the webinar is available at: <http://bit.ly/Fair-lending-webinar>. The following federal agencies participated in the webinar: the U.S. Department of Justice, the U.S. Department of Housing and Urban Development, the Consumer Financial Protection Bureau, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Board.

² The procedures are available at: <http://www.ffiec.gov/pdf/fairlend.pdf>. The appendix to the procedures is available at: <http://www.ffiec.gov/pdf/fairappx.pdf>.

Outlook Advisory Board

Tracy Basinger, Vice President, BS&R,
Federal Reserve Bank of San Francisco

Karin Bearss, Assistant Vice President,
SRC, Federal Reserve Bank of Minneapolis

John Insley, Jr., Assistant Vice President,
BS&R, Federal Reserve Bank of Richmond

Constance Wallgren, Chair, Vice President,
SRC, Federal Reserve Bank of Philadelphia

Outlook Staff

Editors Kenneth Benton
Sally Burke
Robin Myers

Designer Dianne Hallowell

Research Assistants..... Micah Spector
Laura Gleason

Casey McHugh

Project Manager Marilyn Rivera

Consumer Compliance Outlook is published quarterly and is distributed to state member banks and bank holding companies supervised by the Board of Governors of the Federal Reserve System. The current issue of **Consumer Compliance Outlook** is available on the web at: <http://www.consumercomplianceoutlook.org>.

Suggestions, comments, and requests for back issues are welcome in writing, by telephone (215-574-6500), or by e-mail (Outlook@phil.frb.org). Please address all correspondence to:

Kenneth Benton, Editor
Consumer Compliance Outlook
Federal Reserve Bank of Philadelphia
Ten Independence Mall
SRC 7th Floor NE
Philadelphia, PA 19106

The analyses and conclusions set forth in this publication are those of the authors and do not necessarily indicate concurrence by the Board of Governors, the Federal Reserve Banks, or the members of their staffs. Although we strive to make the information in this publication as accurate as possible, it is made available for educational and informational purposes only. Accordingly, for purposes of determining compliance with any legal requirement, the statements and views expressed in this publication do not constitute an interpretation of any law, rule, or regulation by the Board or by the officials or employees of the Federal Reserve System.

VIEW FROM THE FIELD: COMMONLY CITED COMPLIANCE VIOLATIONS IN 2011

BY JUSTIN WINDSCHITL, EXAMINER, FEDERAL RESERVE BANK OF MINNEAPOLIS ¹

INTRODUCTION

To help identify current compliance risks, financial institutions often ask their regulators which violations of regulations are frequently cited during consumer compliance examinations. To address this question, we identified some of the common violations of regulations cited by compliance examiners at the 12 regional Federal Reserve Banks during 2011:

- Regulation B's requirements for spousal signatures and adverse action notices;
- Regulation X's tolerance requirements for settlement cost disclosures in the good faith estimate (GFE);
- Regulation H's requirements for forced-placed flood insurance;
- Regulation C's requirements for rate-spread loans, loan purpose, and action taken; and
- Regulation Z's table-format requirement for certain account-opening disclosures for open-end (not home-secured) credit.

This article discusses these violations and provides guidance and resources to facilitate compliance.

COMMON VIOLATIONS OF REGULATIONS

Regulation B/Equal Credit Opportunity Act

Spousal Signatures

When a married applicant applies for credit individually and qualifies under the creditor's standards for creditworthiness, the creditor is prohibited by 12 C.F.R. §1002.7(d)(1) from requiring the signature of the applicant's spouse on the credit instrument subject to limited exceptions. The exceptions in §1002.7(d) include when the spouse's signature is necessary under applicable state law to provide a secured creditor access to collateral in the event of default or to provide an unsecured creditor access to property relied upon in the event of death or default. A spouse's signature is also permissible on the credit instrument if the applicant does not qualify under the creditor's lending standard and the spouse chooses to provide credit support.

If an applicant intends to apply for credit jointly with a spouse, their joint intent must be evidenced at the time of application. Signatures on the promissory note are insufficient. Also, the method used to establish joint intent must be distinct from the means used to affirm the accuracy of information in the application. For example, financial statements affirming the veracity of information do not establish joint intent. But creditors can rely on signatures or initials on a credit application affirming the applicants' intent to apply jointly. ²

¹ Thanks to Micah Spector of the Federal Reserve Bank of Philadelphia, who contributed the section on adverse action requirements.

² See Comment 1002.7(d)(l)-3. Appendix B to Regulation B contains model application forms with a joint intent box.

In 2008, *Outlook* published an article titled “Regulation B and Marital Status Discrimination: Are You in Compliance?,” which discussed the spousal signature requirements.³ Today, more than three years later, the requirements under §1002.7(d)(1) continue to present compliance challenges. In some instances, bankers say they require the spouse’s signature on the credit instrument out of an “abundance of caution.” But the regulation does not contain an exception for this circumstance.

Institutions can improve compliance by conducting reviews of loans in which a married applicant applied for credit individually or where the intent of the spouse to apply jointly has not been established, but the institution obtained the spouse’s signature on the credit instrument. The *Outlook* article also noted signature violations frequently occur with commercial or agricultural loans. Banks should therefore be aware of the increased fair lending risk associated with these products. The article also recommended conducting a fair lending risk assessment to identify vulnerable areas in which marital status discrimination could occur. For example, products for which previous violations have been noted should receive higher scrutiny. Finally, institutions should be aware that spousal signature violations can trigger file searches for other affected applicants and require the institution to take corrective action for the affected parties.⁴

Consumer Credit Adverse Action Notices

When a creditor takes adverse action — as defined in §1002.2(c) — on a consumer credit application or existing consumer account, the creditor is required by §1002.9(a)(2) to provide a written adverse action notice that discloses the action taken by the financial institution, the name and address of the institution, the ECOA anti-discrimination notice in §1002.9(b)(1), the name and address of the institution’s regulator, and either the specific reasons for the adverse action or a disclosure of the right to obtain the specific reasons

and the contact information to obtain them.⁵

Examiners noted common violations for two of the adverse action notice requirements: failing to list the statement of reasons for the action taken, and providing reasons for the action taken that are not specific enough.

The statement of reasons must indicate the principal reasons for the adverse action, which “must relate to and accurately describe the factors actually considered or scored by a creditor.” See comment 1002.9(b)(2)-2. The number of reasons should not exceed four because more than four will likely not be meaningful to the applicant.⁶

General explanations such as “credit score below bank policy” or “outside of risk tolerance” are not specific enough and should not be used. Sample Form C-1 found in Appendix C to Part 1002 contains a list of 23 “Principal Reason(s) for Credit Denial, Termination, or Other Action Taken Concerning Credit” and includes a 24th option for “Other, specify.” If the reasons for taking adverse action are not included in Sample Notice C-1, such as “inadequate down payment” or “no deposit relationship with us,” those can be included.⁷ Simply picking the closest identifiable factor listed is not sufficient.

Some best practices for adverse action notices include providing a second-level review of notices. For commercial loans, if the creditor discloses the action taken orally, it should make a contemporaneous notation of the call in its file to demonstrate compliance.

Since adverse action notices are often prepared by internal software or third-party programs, the software must reflect current regulatory requirements. If the software an institution uses for creating adverse action notices uses drop-down menus, options that are too vague should be removed. For example, instead of stating “credit score too low,” address the reasons behind

CONTINUED ON PAGE 13

³ <http://bit.ly/spousal-signature>

⁴ For institutions supervised by the Board of Governors of the Federal Reserve System (Board), the corrective action requirements for spousal signature violations are discussed on pages 5-7 of the Board’s *Supervisory Enforcement Policy for the Equal Credit Opportunity Act and the Fair Housing Act*, which is available at: http://bit.ly/ECOA-FHA_enforce. Institutions supervised by another federal banking agency should consult with their regulator.

⁵ For business credit, the requirements are slightly different. See §1002.9(a)(3).

⁶ Comment 1002.9(b)(2)-1

⁷ 12 C.F.R. part 1002, Appendix C-3

RISK-BASED PRICING NOTICE REQUIREMENTS: QUESTIONS AND ANSWERS

BY REBECCA REAGAN, SUPERVISORY EXAMINER, FEDERAL RESERVE BANK OF RICHMOND

In 2011, *Outlook Live* hosted a webinar to present the new risk-based pricing rules required under §311 of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act). As a follow-up, this article provides answers to the most frequently asked questions during the webinar. For a detailed discussion of the risk-based pricing notice requirements, refer to articles on this topic in the Fourth Quarter 2010 and the Third Quarter 2011 issues of *Outlook*, which are available at <http://bit.ly/rb-article> and <http://bit.ly/rbp-credit-score>, respectively.

QUESTIONS AND ANSWERS

1. Must risk-based pricing notices be provided to denied applicants?

Section 1022.72(a) of Regulation V (12 C.F.R. Part 1022) specifies when a creditor must provide a risk-based pricing notice to a consumer applying for credit, subject to the exceptions in §1022.74. If an application is denied and an adverse action notice is provided, a risk-based pricing or exception notice is *not* required. See §1022.74(b).

2. What are the specific timing requirements for provision of the disclosures?

The timing requirements for the risk-based pricing notices vary with the type of credit product and notice:

Risk-Based Pricing Notices

- Closed-end credit: before consummation, but not before credit approval is communicated to the consumer. See §1022.73(c)(1)(i).
- Open-end credit: before the first transaction is made under the plan, but not before credit approval is communicated to the consumer. See §1022.73(c)(1)(ii).
- Account review: when the decision to increase the annual percentage rate (APR) is communicated to the consumer, if advance

notice of an APR increase is required to be given to the consumer. If advance notice of the increase in the APR is not required,¹ no later than five days after the effective date of the change in the APR. See §1022.73(c)(1)(iii).

- Automobile lending: before consummation, but not before credit approval is communicated to the consumer. If the creditor relies on the dealer to deliver the notice, the creditor must maintain reasonable policies and procedures to verify that the dealer or other party provides the notice within the required time frame. See §1022.73(c)(2).
- Contemporaneously granted open-end credit plans: if credit is granted contemporaneously with a purchase of goods or services, the risk-based pricing notice may be provided at the time of the first mailing by the creditor to the consumer after credit is granted or within 30 days after the decision to approve credit, whichever is earlier. For example, a consumer may apply for and be approved for a credit card when making a purchase at a department store. If a notice is required to be given to the consumer, the creditor may provide the notice in a mailing containing the account agreement or the credit card or within 30 days after the decision to approve credit, whichever is earlier. See §1022.73(c)(3).

Credit Score Exception Notices

- If the creditor chooses to provide an exception notice under §1022.74(d) or (e) in lieu of a risk-based pricing notice, the exception notice must be provided to the consumer as soon as reasonably practicable after requesting the consumer's credit score, but not later than consummation for closed-end credit or when the first transaction is made for open-end credit. See §§1022.74(d)(3)

¹ Under Regulation Z, in some instances account changes for open-end credit products do not require a change-in-terms notice. The requirements for change-in-term notices are covered in §1026.9(c)(1) for home equity line of credit plans and in §1026.9(c)(2) for open-end credit (not home-secured).

(residential mortgage consumer credit) and 1022.74(e)(3) (nonresidential mortgage consumer credit).

No Credit Score Notice

- When a consumer does not have a credit score (for example, because of insufficient credit history), the “no credit score” notice required by §1022.74(f)(1)(i) must be provided as soon as reasonably practicable after the person has requested the credit score, but not later than consummation for closed-end credit or when the first transaction is made for an open-end credit plan. See §1022.74(f)(4).

3. If the same rates are charged to all approved applicants for a particular product, do notices need to be provided?

As discussed in §1022.74(a)(1), if a lender offers one rate for a product and the applicant either receives that rate or is denied, no risk-based pricing or exception notice is required for approved applicants but an adverse action notice is still required for denied applicants.

4. If all mortgage applicants receive the notice of credit score disclosure required by §609(g), do risk-based pricing notices need to be provided if a consumer receives less favorable terms based on information in a credit report?

Yes. Lenders are required to comply with the risk-based pricing rules by providing either a risk-based pricing notice (§1022.72(a)), a credit score exception notice (§1022.74(d)(1)(ii) or (e)(1)(ii)), a no credit score notice (§1022.74(f)), or an adverse action notice (§1022.74(b)), as appropriate. For loans secured by one to four units of residential real property, simply providing a §609(g) disclosure is insufficient because it does not contain all of the disclosures required by the risk-based pricing or credit score exception notices. To facilitate compliance, mortgage lenders have the option under §1022.74(d) of providing a credit score exception notice to *all* mortgage applicants (model form H-3) in lieu of *both* the §609(g) notice and the risk-based pricing notice. The model form exception notice contains all of the information required by §609(g) plus required additional disclosures, includ-

ing a bar graph showing how the consumer’s score compares to other consumers using the same scale, a statement that federal law gives consumers the right to obtain a copy of their credit report from the consumer reporting agency, and a statement directing consumers to the websites of the Board of Governors of the Federal Reserve System (Board) and Federal Trade Commission (FTC) to obtain more information about consumer reports.

Readers should also be aware that §1100F of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amended the risk-based pricing disclosure requirements effective July 21, 2011, to require creditors to disclose credit scores in their risk-based pricing notice if the score was used in setting the material terms or in an adverse action notice if the score was used in taking adverse action. The Board and the FTC jointly issued a final rule to implement §1100F’s requirements. See 76 Fed.Reg. 41,602 (July 15, 2011). *Outlook* discussed these requirements in the Third Quarter 2011 issue (“An Overview of the Credit Score Disclosure Requirements for Risk-Based Pricing Notices.”) Under the final rule, providing a credit score exception notice to all mortgage applicants satisfies the new credit score disclosure requirements with respect to applicants qualifying for a risk-based pricing notice. However, if the creditor takes adverse action (for example, denying the credit application) and relied on a credit score in making this decision, the creditor must still disclose the credit score in the adverse action notice, *even though the creditor already provided a credit score exception notice or a §609(g) notice*. See 76 Fed. Reg. at 41,596.

5. If a consumer reporting agency finds no credit file for an applicant, is the creditor required to provide any type of disclosure?

Under §1022.74(f), if a creditor regularly obtains credit scores from a consumer reporting agency but a credit score is not available from that agency for an applicant, the creditor is not required to provide a risk-based pricing notice. Instead, the creditor must provide the applicant with a notice indicating that no credit score was available. Section 222.74(f)(1)(iii) lists the information that must be included in the notice or creditors may instead use model form H-5 (loans where credit score is not available).

CONTINUED ON PAGE 16

NEWS FROM WASHINGTON: REGULATORY UPDATES

Consumer Financial Protection Bureau (CFPB) conducts a hearing on payday lending and issues examination procedures. Section 1024(a)(1)(E) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) provided the CFPB with examination and supervisory authority for payday lenders. On January 19, 2012, the CFPB conducted a hearing in Birmingham, Alabama, to gather information about the payday lending market to inform its supervisory authority. Richard Cordray, the CFPB's director, presided. A video of his presentation is available at: <http://1.usa.gov/cordray-payday>. On a related note, the CFPB issued its payday lender examination procedures, which are available at: <http://bit.ly/payday-exam>.

CFPB issues a final rule on foreign remittance transfers and a rulemaking proposal on related issues. Section 1073 of the Dodd-Frank Act created new consumer protections for remittance transfers to foreign countries. On January 24, 2012, the CFPB announced a final rule amending Regulation E to implement §1073. The rule requires providers of remittance transfers, including depository institutions, to make disclosures to a consumer before the consumer pays for a remittance transfer. The information that must be disclosed includes the exchange rate, fees, and the amount of money to be delivered. Providers must also supply a receipt or proof of payment that repeats the information in the disclosure and informs consumers of the date on which the money will arrive. Generally, the disclosures must be in English, but sometimes providers must also make the disclosures in other languages. The rule becomes effective in January 2013.

The CFPB also issued a rulemaking proposal seeking public comments on changes to the final rule that would ease the compliance burden in certain cases. Specifically, the CFPB proposed to exempt from coverage small entities that do not routinely provide remittance transfer services. The proposal would also give remittance providers some flexibility in complying with disclosure rules when consumers authorize transfers in advance. The CFPB's announcement and the two *Federal Register* notices are available at: <http://1.usa.gov/CFPB-remittance>.

CFPB launches nonbank supervision program. On January 5, 2012, the CFPB launched the first federal nonbank supervision program, as authorized by §1024 of the Dodd-Frank Act. The program is an extension of the bank supervision program that began last July and will ensure that banks and nonbanks comply with federal consumer financial laws. The announcement is available at: <http://1.usa.gov/CFPB-nonbank>.

Agencies release annual CRA asset-size threshold adjustments for small and intermediate small banks. On December 19, 2011, the federal bank regulatory agencies announced the annual adjustment to the asset-size thresholds used to define small bank, small savings association, intermediate small bank, and intermediate small savings association under the Community Reinvestment Act (CRA) regulations. Financial institutions are evaluated under different CRA examination procedures based on their asset-size classification. Institutions that fall under the small and intermediate small asset-size thresholds are not subject to the reporting requirements applicable to large banks. Annual adjustments to these asset-size thresholds are based on the change in the average of the consumer price index (CPI) for urban wage earners and clerical workers, not seasonally adjusted, for each 12-month period ending in November. The definitions of small and intermediate small institutions for CRA examinations will change as a result of the 3.43 percent increase in the CPI index for the period ending in November 2011. Effective January 1, 2012, the asset-size thresholds are as follows: "Small bank" or "small savings association" means an institution that, as of December 31 of either of the prior two calendar years, had assets of less than \$1.160 billion, while "intermediate small bank" or "intermediate small savings association" means a small institution with assets of at least \$290 million as of December 31 of both of the prior two calendar years, and less than \$1.160 billion as of December 31 of either of the prior two calendar years. The agencies' joint announcement and the *Federal Register* notice are available at: <http://1.usa.gov/2012-cra>.

CFPB aims to simplify credit card agreements. On December 7, 2011, the CFPB launched a new "Know



Before You Owe” project aimed at simplifying credit card agreements so that the prices, risks, and terms are easier for consumers to understand. The CFPB is soliciting public comment on a prototype credit card agreement that is shorter, is written in plain language, and explains key features upfront. The prototype agreement is designed to make it easier for consumers to understand their credit cards. The CFPB will also host an online database of many existing credit card agreements where consumers can compare their existing agreement with the prototype. Under the Credit CARD Act, card issuers are required to provide copies of their credit card agreements to the CFPB for inclusion in a public database that consumers can access to view their card agreements. The announcement is available at: <http://1.usa.gov/CFPB-cards>.

CFPB releases report on credit card complaints.

On November 30, 2011, the CFPB issued a report discussing its first three months of collecting credit card complaint data, during which time it received more than 5,000 credit card complaints. Of these complaints, companies reported resolving more than 3,100, with consumers disputing the adequacy of the responses in only 400 cases, or less than 13 percent of the time. The report provides a breakdown of complaints by type and their progress through the complaint-handling system. The report also includes three observations about the complaint data: many consumers struggle to understand the terms of credit cards and associated products like debt protection services; some consumers are reporting instances of allegedly fraudulent charges to their credit cards by third parties; and many complaints involve factual disputes between the consumer and the card issuer. The CFPB’s announcement and the report are available at: <http://1.usa.gov/CFPB-complaints>.

CFPB seeks input on streamlining inherited regulations. On November 29, 2011, the CFPB announced that it is seeking public input on ways to streamline regulations that the agency inherited from seven different federal agencies under the Dodd-Frank Act. The notice and request for information ask the public to identify provisions of the inherited regulations that the agency should make the highest priority for updating, modifying, or eliminating

because they are outdated, unduly burdensome, or unnecessary. The CFPB also seeks suggestions for practical measures it could take to make complying with the regulations easier. Opportunities for streamlining rules and facilitating compliance may include simplifying regulations that have become unnecessarily difficult to understand and comply with over time; standardizing definitions of common terms across regulations where statutes permit; updating regulations that are outdated or unnecessary due to changing technologies; or removing unnecessary restrictions on consumer choice or business innovation. The CFPB will also consider practical measures to make it easier for firms, especially smaller ones, to comply with the inherited regulations. Comments were due by March 5, 2012. The announcement is available at: <http://1.usa.gov/cfpb-streamline>.

CFPB collects information from students, schools, industry, and other stakeholders on the private student loan market.

Section 1077 of the Dodd-Frank Act requires the CFPB and the Department of Education, in consultation with the Department of Justice and the Federal Trade Commission, to prepare a report on private education loans and lenders. In support of the study, the CFPB on November 16, 2011 published a notice and request for information to collect data on a series of issues affecting private student loans from origination to servicing to collection. The notice asked the public, students, families, the higher education community, and the student loan industry (lenders and servicers) to voluntarily provide information about the role of schools in the marketplace, underwriting criteria, repayment terms and behavior, impact on choice of field of study, career choice, servicing, loan modification, financial education, and default avoidance. The CFPB will use the information to prepare its report on private education loans and lenders and to prioritize its own regulatory and education work. Comments were due by January 17, 2012. The CFPB’s announcement and the *Federal Register* notice are available at: <http://1.usa.gov/cfpb-pel>.

REGULATION Z – TRUTH IN LENDING ACT (TILA)

A creditor's use of the wrong rescission notice model form does not trigger the right of rescission.

Watkins v. SunTrust Mortgage, Inc., 663 F.3d 232 (4th Cir. 2011). The Fourth Circuit affirmed the dismissal of a lawsuit seeking to rescind the refinancing of a mortgage because the creditor provided the borrower with Regulation Z model form H-8, the general rescission notice form for a new credit transaction, when form H-9 (a refinancing with the same creditor) was appropriate for the transaction. The primary difference between these forms is that form H-9 informs the borrower that the right of rescission applies only to the new credit transaction and does not allow rescission of the prior loan. In affirming the dismissal, the court noted that §1604(b) of TILA permits creditors to modify the model forms by “deleting any information which is not required [by TILA].” Because §1635(b) of TILA requires creditors to provide borrowers with the rescission notice in certain credit transactions but does not distinguish between a refinancing with a new creditor or the current creditor, the court concluded that TILA does not require the additional information in form H-9. The borrower also argued that the use of form H-8 violated TILA because it incorrectly implied that the borrowers had the right to cancel not only the refinancing but also the original loan. The court rejected this argument because if the borrower cancelled the refinancing, the parties would return to their position before the refinancing, which would not affect the original loan. The court also noted that even if the additional language of form H-9 were required, the creditor did not violate TILA because the additional information was substantially included in form H-8, and “TILA’s regulations should be reasonably construed and equitably applied.” However, one member of the three-judge panel dissented.

The federal appeals courts are divided over whether a creditor’s use of the wrong model rescission form allows a borrower to exercise the right of rescission for up to three years after consummation. The Seventh Circuit (covering the states of Illinois, Wisconsin, and Indiana) holds that it does (see *Handy v. Anchor Mortgage Corp.*, 464 F.3d 760 (7th Cir. 2006)), while the First Circuit (Maine, Massachusetts, New Hampshire, Puerto Rico, and Rhode Island), Eleventh Circuit (Florida, Georgia, and Alabama), and now the Fourth Circuit (Maryland, North Carolina, South Carolina, Virginia, and West Virginia) hold that it does not. See *Santos-Rodriguez v. Doral Mortgage Corp.*, 485 F.3d 12, 18 (1st Cir. 2007), *Veale v. Citibank*, 85 F.3d 577, 580 (11th Cir. 1996), and *Watkins*.

Borrower can rebut TILA presumption of receiving rescission notice through testimony.

Marr v. Bank of America, N.A., 662 F.3d 963 (7th Cir. 2011). *Outlook* reported in the fourth quarter 2011 issue on the recent case of *Cappuccio v. Prime Capital Funding LLC*, 649 F.3d 180 (3d Cir. 2011), in which the Third Circuit held that a borrower could, through his testimony, overcome the presumption in §1635(c) of TILA that a borrower signing a form acknowledging receipt of disclosures has, in fact, received them. In a new case, the Seventh Circuit reached a similar conclusion. The borrower obtained a refinancing loan. At closing, he was allegedly provided with two copies of the rescission notice and signed a form acknowledging this. However, when the borrower checked his papers several years later, he found only one copy of the rescission notice. The borrower sought to rescind the loan because he received only one copy of the rescission notice, and Regulation Z requires creditors to provide two copies. See §1026.23(b)(1). The trial court dismissed the case because the borrower signed an acknowledgment form, but the Seventh Circuit reversed the ruling. The appeals court, after noting the recent decision in *Cappuccio*, focused on the text of §1635(c), stating that “this section does no more than create a rebuttable presumption of delivery thereof” and determined that Congress “was warning courts not to overrate the importance of the acknowledgment.” The court held that the plaintiff could overcome the presumption by producing sufficient evidence to convince a jury he did not receive two copies of the rescission notice. The case was remanded for further proceedings.



FAIR HOUSING ACT (FHA)

The city of St. Paul, Minnesota withdraws its Supreme Court appeal to determine if the FHA covers disparate impact claims. *Gallagher v. Magner*, 2012 WL 469885 (No. 10-1032, Feb. 14, 2012). In November 2011, the Supreme Court granted a petition by the city of St. Paul, Minnesota, to review a decision from the Eighth Circuit, *Gallagher v. Magner*, 619 F.3d 823, *rehearing en banc denied*, 636 F.3d 380 (8th Cir. 2010), to determine if the statutory language of the FHA encompasses disparate impact claims. However, on February 14, 2012, the court granted the city's request to voluntarily dismiss the appeal. This case has been closely followed by the banking industry, regulators, and community groups not only because it had the potential to eliminate disparate claims under the FHA but also because such a ruling might affect disparate impact claims under the Equal Credit Opportunity Act (ECOA) and Regulation B.

Disparate impact claims originated under federal employment discrimination law. Both Title VII of the Civil Rights Act of 1964 and the Age Discrimination in Employment Act of 1967 (ADEA) contain language prohibiting employer actions that have a discriminatory *effect* on protected-class employees. Based on this language, the Supreme Court held in *Smith v. City of Jackson, Mississippi*, 544 U.S. 228 (2005) that disparate impact claims are permissible under the ADEA. The FHA lacks similar language prohibiting discriminatory effects, which prompted the city to seek review in the Supreme Court on this issue. The text of the ECOA also lacks discriminatory effects language. On a related note, the Department of Housing and Urban Development released a rulemaking proposal to clarify the legal standards for disparate impact claims under the FHA. The proposal is available at <http://1.usa.gov/fha-disparate>.

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

The U.S. Supreme Court will resolve a circuit split on RESPA's unearned fee prohibition. *Freeman v. Quicken Loans, Inc.*, 132 S.Ct. 397 (No. 10-1042, Oct. 11, 2011). The Supreme Court agreed to review a Fifth Circuit case, *Freeman v. Quicken Loans, Inc.*, 626 F.3d 799 (5th Cir. 2010), to determine if RESPA's prohibition in §8(b) on unearned fees applies only when fees are split between two or more parties or also applies to a single party charging an unearned fee. The federal appeals courts are divided on this issue. In the *Freeman* case, the plaintiffs alleged that a loan discount fee Quicken Loans charged was unearned because the borrower did not receive a reduction in the interest rate. The Fifth Circuit held that the language of §8(b) stating "no person shall give and no person shall accept" requires that at least two parties split a fee for §8(b) to apply. Because Quicken Loans did not split the loan discount fee, the court held that RESPA §8(b) did not apply. A decision in the *Freeman* case is expected by the end of the court's current term in June 2012.

Fees assessed after a real estate closing are not settlement services subject to RESPA. *Molosky v. Washington Mutual, Inc.*, 664 F.3d 109 (6th Cir. 2011). The Sixth Circuit affirmed the dismissal of a class-action case alleging that a post-closing payoff statement fee and recording fee assessed by a loan servicer violated the fee-splitting prohibition in §8(b) of RESPA. In affirming the dismissal, the court noted that §8(b) applies only to "settlement services" of federally regulated mortgage loans. Regulation X defines settlement as "the process of executing legally binding documents regarding a lien on property that is subject to a federally related mortgage loan." Based on this definition, the court determined that "settlement services" are limited to services performed before or at the property transfer. Because the fees at issue were assessed after the property transfer, §8(b) did not apply. The trial court stated as an alternative basis for dismissing the case that RESPA did not apply because the fees in question were not split with another party. The Sixth Circuit declined to address this issue because, as discussed above, that issue is currently before the Supreme Court in the *Freeman* case.

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

FAIR LENDING WEBINAR QUESTIONS AND ANSWERS

In addition, we have increased our communications with banks during the examination process, particularly with respect to statistical reviews. We often conduct statistical analyses of electronic data we obtain from banks to determine if there are any disparities in lending based on factors protected by the fair lending laws. We find that these reviews are very effective and more efficient for both the examiners and the banks. In most cases, our statistical analyses do not identify concerns. In some cases where we have found problems, some community bankers noted that they had difficulty understanding the statistical analysis. We have taken this concern seriously, and we now take additional steps to communicate with community banks to ensure that they understand the fair lending concerns raised by the analysis and how to respond effectively.

Finally, we engage in a variety of outreach activities on fair lending, such as regularly participating in conferences sponsored by the industry, consumer advocates, and our Reserve Banks. Our goal is to highlight fair lending risks so that institutions can take steps on their own to effectively manage fair lending compliance.

2. **For nonmortgage loans, what methods does the Board currently use to determine the borrower's race/ethnicity/gender?**

For mortgage loans, we can determine the borrower's race/ethnicity/gender based on the data collected pursuant to the Home Mortgage Disclosure Act (HMDA). For nonmortgage loans, we may determine ethnicity and gender using the U.S. Census Bureau's Spanish surname list and female first name list. For both mortgage and nonmortgage products, we also use census data to identify majority-minority census tracts and to determine whether disparities exist between minority and nonminority areas.

REDLINING

3. **What factors does the Board consider in a redlining review? In particular, what statistical analysis is typically conducted?**

The Board considers several factors in a redlining review. With respect to statistical analysis, we typically evaluate whether the bank's lending in majority-minority tracts is similar to that of other lenders in the reasonably expected market area. However, a full review of the lender's practices is necessary to determine whether a problem exists.

As noted in the procedures, other potential risk factors for redlining include:

- Irregularly shaped Community Reinvestment Act assessment areas that fail to comply with Regulation BB and that exclude minority areas;
- Branching strategies and expansion plans that disfavor minority neighborhoods;
- Marketing strategies that exclude minority geographies; and
- Complaints about redlining by consumers or community advocates.

PRICING

4. **What factors does the Board consider in a pricing review? In particular, what statistical analysis is typically conducted?**

The Board conducts statistical pricing reviews of mortgage and nonmortgage products and uses a lender-specific approach to statistical modeling. That is, we create a statistical model based on the bank's specific pricing policies. Generally, we rely on the bank's written policies, including rate sheets, and on other information obtained during the examination. Based on a bank's policies, typical fields in a pricing model may include credit score, loan-to-value ratio, loan amount, loan term, product code, and documentation type. We generally examine disparities in the annual percentage rate. Additionally, when the data are available, we may evaluate overages, fees or yield spread premiums, and pricing exceptions.

As noted in the procedures, potential risk factors for pricing include:

- Lack of specific guidelines for pricing (including exceptions);

- Use of risk-based pricing that is not based on objective criteria or applied consistently;
- Broad pricing discretion, such as through overages, underages, or yield spread premiums;
- Lack of clear documentation of reasons for pricing decisions (including exceptions);
- Lack of monitoring for pricing disparities;
- Financial incentives for loan originators to charge higher prices;
- Pricing policies or practices that treat applicants differently on a prohibited basis or have a disparate impact;
- Loan programs that contain only borrowers from a prohibited basis group; and
- Complaints about pricing by consumers or community advocates.

UNDERWRITING

5. With the recent tightening of underwriting standards, will the Board be focusing more on underwriting disparities?

The Board recognizes that many lenders have tightened underwriting standards. We believe that sound underwriting policies promote fair and responsible lending. Concerns have been raised, however, that certain stricter underwriting policies, such as tighter credit standards in specific geographic markets, could have a disproportionate effect on access to credit for minorities. To ensure fair lending compliance, lenders should review underwriting policies for fair lending risk, including both disparate treatment and disparate impact discrimination. To manage disparate impact risk, lenders should pay particular attention to policies that vary by origination channel or geography. They should ensure that the policies serve legitimate business needs and do not have an illegal disparate impact. To manage disparate treatment risk, lenders should ensure that policies are clear and consistently applied. In accordance with the procedures, the Board conducts underwriting analyses when appropriate and evaluates whether lenders' policies may violate fair lending laws. Thus

far, we have not identified any fair lending violations related to stricter underwriting standards.

MATERNITY LEAVE DISCRIMINATION

6. How can a lender mitigate fair lending risk if a credit applicant is on maternity leave at the time of the application?

Recently, some lenders have refused to consider a woman's employment status or income while she is on maternity leave.³ Such a policy may violate the Fair Housing Act and Equal Credit Opportunity Act (ECOA) on the basis of sex and the Fair Housing Act on the basis of familial status. The policy may also violate Regulation B, which prohibits using assumptions related to the likelihood that any group of persons will rear children or will, for that reason, receive diminished or interrupted income in the future. The Board had one referral on this issue in 2011.

A lender may mitigate its fair lending risk by:

- Not assuming that a woman will not return to work after childbirth;
- Using underwriting policies that treat applicants on maternity/parental leave and applicants on other types of leave similarly;
- Consulting with its investors to understand the requirements for considering and verifying the income of an applicant on maternity/parental leave;
- Reviewing and addressing complaints by consumers who were on maternity/parental leave at the time of the application; and
- Reviewing recent settlements to learn about problematic practices.

THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

7. How did the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) change the HMDA requirements, and how will those changes affect the examination process for mortgage loans?

³ See, for example, "HUD Acts Against Pregnancy Discrimination in Home Mortgages," available at: <http://1.usa.gov/hud-pregnancy>.

Section 1094 of the Dodd-Frank Act amended HMDA to require financial institutions to collect and report the new data for mortgage loans. In addition, the Dodd-Frank Act transferred responsibility for issuing implementing regulations under HMDA from the Board to the Consumer Financial Protection Bureau (CFPB). At this time, the CFPB has not issued rules to implement the changes to HMDA and revise Regulation C. After final rules have been issued and become effective, the Board will use the new data in its fair lending examinations.

The new data will include the following as well as any other information that the CFPB may require:

- Origination channel (retail, broker, or other)
- Applicant's age
- Applicant's credit score
- Property value
- Loan term
- Term (in months) of any introductory interest rate period
- Rate spread for all loans
- Total points and fees payable at origination
- Term (in months) of any prepayment penalty
- Negative amortization
- Loan originator unique identifier, universal loan identifier, and parcel loan number (as the CFPB may determine appropriate)

8. How did the Dodd-Frank Act change ECOA and how will those changes affect the examination process?

ECOA has always applied to all types of credit, including business loans. However, the Dodd-Frank Act's changes to ECOA will facilitate a more robust analysis. Specifically, §1071 of the Dodd-Frank Act amended ECOA to require financial institutions

to collect and report data for loans to minority-owned and women-owned businesses, and small businesses. In addition, responsibility for issuing implementing regulations under ECOA was transferred from the Board to the CFPB, except with respect to motor vehicle dealers. Both the Board and the CFPB have clarified that although §1071 became effective on the designated transfer date of July 21, 2011, financial institutions and motor vehicle dealers are not subject to the new data-collection and reporting requirements until final implementing regulations are issued and become effective.⁴ At this time, neither the CFPB nor the Board has issued these rules. After final rules are issued and become effective, the Board will use the new data in its fair lending examinations.

The new data will include the following as well as any other information that the CFPB may require:

- Application number and date
- Race, ethnicity, and gender of the principal owner
- Census tract of the business
- Gross annual revenue of the business in the last fiscal year
- Loan type and purpose
- Type of action taken and date
- Amount of credit applied for and approved

9. How did the Dodd-Frank Act change the statute of limitations for ECOA violations?

Section 1085 of the Dodd-Frank Act amended ECOA to allow actions in federal district court no later than five years after the date of the occurrence of the violation. Previously, the statute of limitations was two years from the date of the occurrence. ©

⁴ See April 11, 2011 Letter from CFPB General Counsel Leonard Kennedy (available at: <http://bit.ly/CFPB-hmda>) and the Board's final rule discussing the timing of the data-collection requirements for motor vehicle dealers. 76 Fed. Reg. 59,237 (Sept. 26, 2011).

VIEW FROM THE FIELD: COMMONLY CITED COMPLIANCE VIOLATIONS IN 2011

the low credit score, such as “limited credit experience” or “delinquent past or present obligations with others.” Since the purpose of the notice is to tell the applicant why the application was denied, the reason specified should be clear to the applicant. Finally, as with spousal signature violations, adverse action notice violations can trigger file searches for other affected applicants and require the institution to take corrective action for the affected parties.⁸

Regulation X/Real Estate Settlement Procedures Act *Tolerance Cures*

The U.S. Department of Housing and Urban Development (HUD) made significant changes to the RESPA GFE and HUD-1 disclosure forms effective January 1, 2010.⁹ The changes include a new requirement that certain settlement costs disclosed in the final HUD-1 cannot exceed the estimate of those costs on the GFE by more than a specified tolerance.¹⁰ The revised rule establishes three categories of settlement charges, with different tolerances for each category. See 12 C.F.R. §1024.7(e). If the actual charge for a settlement cost listed on the HUD-1/1a exceeds the estimated charge for the cost disclosed on the GFE by more than the applicable tolerance, and none of the tolerance exceptions in §1024.7(f) apply, the lender is required under §1024.7(i) to cure the discrepancy within 30 calendar days of settlement by reimbursing the borrower for the amount by which the tolerance was exceeded. The lender must also provide the borrower with a revised HUD-1 reflecting the cure.¹¹

In some cases, lenders are exceeding the tolerances and failing to reimburse the consumer in a timely manner to the extent that the actual costs exceed the applicable tolerances. It is important to recognize that a creditor does not automatically violate Regulation X when exceeding the tolerance. A violation occurs only if a creditor exceeds a tolerance *and* fails to cure it in a timely manner.

Institutions can establish formal procedures for tolerance cures specifying how to respond when tolerances are exceeded. A thorough pre- or post-closing loan review (within 30 days of settlement) that specifically targets compliance with the requirements for tolerance cure can also be an effective internal control.

Regulation H/National Flood Insurance Act (NFIA) *Forced-placed Insurance*

The implementing regulations for the NFIA¹² require that if at any time during the term of the loan a lender or servicer determines that the collateral has less flood coverage than is required by the NFIA, it must notify the borrower to obtain the required insurance. See 12 C.F.R. §208.25(g). The notice should state that if the borrower does not obtain the insurance within 45 days, the lender will purchase the insurance on behalf of the borrower and may charge the borrower for the cost of premiums and fees to obtain the coverage. The banking agencies recently clarified their expectation that if a borrower is sent a 45-day notice and fails to obtain flood insurance within that period, the agencies expect the lender to force-place insurance on the 46th day.¹³

⁸ *Supervisory Enforcement Policy for the Equal Credit Opportunity Act and the Fair Housing Act*, pp. 7-8

⁹ HUD's final rule is available at: <http://1.usa.gov/hud-respa>. Rulemaking authority for RESPA transferred to the Consumer Financial Protection Bureau (CFPB) effective July 21, 2011. On December 20, 2011, the CFPB published an interim final rule to republish HUD's Regulation X, 24 C.F.R. part 3500, as a CFPB regulation, 12 C.F.R. part 1024. The *Federal Register* notice for the CFPB's rule, which became effective on December 30, 2011, is available at: <http://1.usa.gov/cfpb-respa>.

¹⁰ See 12 C.F.R. §1024.7(f). *Outlook* reviewed the revised GFE and tolerance requirements in the Second Quarter 2010 issue, available at: <http://bit.ly/respa-outlook>.

¹¹ See “New RESPA Rule FAQs,” <http://1.usa.gov/respa-faq>. Page 42 discusses how to complete a revised HUD-1 to reflect a cure.

¹² The federal banking agencies' flood insurance implementing regulations for NFIA are codified at 12 C.F.R. §208.25 (Regulation H) for institutions supervised by the Board; 12 C.F.R. part 172 for institutions supervised by the Office of the Comptroller of the Currency; 12 C.F.R. part 339 for institutions supervised by the Federal Deposit Insurance Corporation; and 12 C.F.R. part 760 for institutions supervised by the National Credit Union Administration. This article makes reference to the Board's Regulation H, but the other agencies' regulations are substantially similar.

¹³ Interagency Flood Q&A 61. 76 Fed. Reg. 64,175, 64,182 (Oct. 17, 2011). *Outlook* reviewed the forced-placement and other flood insurance regulatory requirements in the Fourth Quarter 2011 issue. <http://bit.ly/flood-outlook>

Forced-placement insurance violations typically arise because the borrower fails to renew a policy when it expires, a matter outside the lender's direct control. A tickler system is an effective way to manage this risk. The system should be designed to send a reminder to the appropriate staff when the renewal date is approaching to verify with the insurer or borrower that the policy is being renewed.

In addition, staff may not understand the forced-placement regulatory requirements. Establishing forced-placement procedures can help guide staff and ensure compliance with regulatory requirements. Finally, some financial institutions are reluctant to force-place insurance because their customers complain about it, and the institution does not want to damage a customer relationship. Because the forced-placement insurance requirements are mandatory, institutions must comply.

THROUGH AWARENESS AND TRAINING, A COMPLIANCE OFFICER CAN HELP ENSURE THAT THE FINANCIAL INSTITUTION AND ITS STAFF ARE IN COMPLIANCE WITH CONSUMER PROTECTION LAWS AND REGULATIONS.

Regulation C/Home Mortgage Disclosure Act *Rate Spread, Loan Purpose Definitions, and Type of Action Taken*

Section 1003.4 of Regulation C requires financial institutions to collect certain loan data for originations and purchases of home-purchase loans, home-improvement loans, and refinancings. Reportable transactions must be recorded within 30 calendar days after the end of the calendar quarter in which the final action is taken and reported annually. HMDA data collection and reporting continue to make the list of common violations at financial institutions, primarily because of the amount of information required to be reported, limited tolerance for errors, and issues related to the

data collection process. In 2011, common violations included errors recording the number of rate spread loans, the loan purpose, and the action taken.

A HMDA-reportable loan qualifies as a rate-spread loan if it is subject to Regulation Z, and the spread between the loan's annual percentage rate and the average prime offer rate for a comparable transaction is equal to or greater than 1.5 percentage points for first-lien loans or 3.5 percentage points for subordinate-lien loans.¹⁴ Loans exempt from Regulation Z, such as investment property loans, should not be reported.

Errors in the loan purpose field are also a common HMDA violation. Section 1003.4(a)(3) requires financial institutions to identify the loan purpose, and the instructions in Appendix A to Regulation C identify the three options: home purchase (code 1), home improvement (code 2), or refinancing (code 3). A careful review of the definitions of loan purposes and of the HMDA reporting exemptions¹⁵ will help ensure accuracy in this area.

In some instances, financial institutions do not understand the "loan purpose hierarchy" that applies to multiple-category loans, i.e., loans that have more than one HMDA-reportable purpose. Specifically, if the loan is a home-purchase loan as well as a home-improvement loan

or a refinancing, the loan will always be reported as a purchase loan. If the loan is for both refinancing and home improvement, financial institutions should report the loan as a home-improvement loan. The loan purpose hierarchy appears in the HMDA Official Staff Commentary for 1003.2.

Another common Regulation C error occurs in the action taken field. Some institutions select Code 2 (application approved but not accepted) when Code 4 (application withdrawn) applies or select Code 4 when Code 2 applies. If an application is approved but the applicant fails to respond to the notification within the specified time, Code 2 should be used, while Code 4

¹⁴ See §1003.4(a)(12). This definition became effective October 1, 2009.

¹⁵ See §1003.4(d) for loans excluded from HMDA reporting.

may be used only when the consumer expressly withdraws the application before a credit decision is made.¹⁶

Understanding HMDA's regulatory requirements can help reduce these errors. A good reference is the Federal Financial Institutions Examination Council's (FFIEC) *A Guide to HMDA Reporting: Getting It Right*, which is available at <http://bit.ly/HMDA-right>. The FFIEC also provides other HMDA resources on its website. Finally, inaccurate collection and reporting of HMDA data may require resubmission of the data.

Regulation Z/Truth in Lending Act

Account Opening Disclosures for Open-End (Not Home-Secured) Credit Plans

The Board of Governors of the Federal Reserve System (Board) amended some of the Regulation Z disclosure requirements for open-end credit (not home-secured) in a January 2009 final rule that became effective July 1, 2010.¹⁷ The changes include new requirements for account-opening disclosures.¹⁸ Consumer testing revealed that consumers responded favorably to a table format that summarized key terms (based on the Schumer Box format used for credit card solicitation and application disclosures). As a result, the Board required in 12 C.F.R. §1026.6(b) that creditors use a table format substantially similar to model form G-17 to disclose certain key account terms.¹⁹

The failure to use a table format substantially similar to model form G-17 has been a frequent violation for account-opening disclosures for overdrafts and personal lines of credit. As with the RESPA tolerance requirements, this violation reflects the compliance challenges that arise with a significant regulatory change. Financial institutions relying on third-party software

to create disclosures should verify that the software reflects the changes in regulatory requirements. For internally created software, institutions should ensure that regulatory changes are communicated in a timely manner to the IT department and that the software is tested to verify that the changes have been implemented. For a more detailed discussion of vendor risk management, refer to the *Outlook* article "Vendor Risk Management" in the First Quarter 2011 issue.²⁰

BEST PRACTICES FOR COMPLIANCE

Compliance officers must exercise vigilance and awareness of the current rules and regulations as well as any and all recent changes to them. In addition to the procedures and resources offered in this article, good policies and procedures and ongoing training are important and practical ways for a financial institution to put itself in the best position to comply with consumer protection regulations.

Training is a critical part of any effort to achieve compliance. Staff cannot be expected to comply with laws and regulations if they do not correctly understand the regulatory requirements. The *Outlook* website contains a list of resources to supplement training and help achieve compliance with the requirements listed above and in other compliance areas.²¹

CONCLUSION

This article discussed common violations identified by Federal Reserve System bank examiners in 2011. Through awareness and training, a compliance officer can help ensure that the financial institution and its staff are in compliance with consumer protection laws and regulations. Specific issues and questions should be raised with your primary regulator. ©

¹⁶ See Appendix A to Regulation C (Form and Instructions for Completion of HMDA Loan Application Register Action Taken section).

¹⁷ 74 Fed. Reg. 5,244 (January 29, 2009), available at: <http://1.usa.gov/open-end-2009>

¹⁸ A report summarizing the testing results (*Design and Testing of Effective Truth in Lending Disclosures*) is available at: <http://1.usa.gov/disclosure-test>.

¹⁹ In December 2011, the CFPB republished the Board's Regulation Z, 12 C.F.R. part 226, as a CFPB regulation, 12 C.F.R. part 1026, in an interim final rule that became effective December 30, 2011. The rulemaking is available at: <http://www.gpo.gov/fdsys/pkg/FR-2011-12-22/pdf/2011-31715.pdf>

²⁰ <http://bit.ly/outlook-VRM>

²¹ <http://bit.ly/outlook-resources>

RISK-BASED PRICING NOTICE REQUIREMENTS: QUESTIONS AND ANSWERS

6. The consumer reporting agency generates the credit score disclosure and includes three scores. Is the lender required to indicate which score was used to price the loan?

As discussed in the *Outlook* article in the Third Quarter 2011 issue, when a creditor uses multiple credit scores in setting the terms of credit, the creditor must disclose any one of those scores. Alternatively, the creditor, at its option, may disclose multiple scores used in setting the material terms of credit. If a creditor obtained multiple credit scores but used only one score, only that score must be disclosed. For example, if the creditor regularly requests scores from several consumer reporting agencies and uses only the lowest score, then the lowest score must be disclosed. See 76 Fed. Reg. 41,602, 41,608-09 (July 15, 2011).

7. If an automobile lender does not pull a credit report but ultimately prices a loan based on an indirect lender's buy rate, which was determined using information from a credit report, who must provide the notice?

The risk-based pricing notice requirements apply to a person who "uses" a consumer report in connection with a credit application. See 15 U.S.C. §1681m(h)(1). When an automobile dealer is the original creditor (i.e., three-party financing), the automobile dealer must provide the required notice (risk-based pricing, adverse action, or credit score exception, as appropriate), even if the dealer immediately assigns the credit agreement to a third-party funding lender, because the automobile dealer has "used" a consumer report by initiating the request to the funding lender that caused the consumer report to be used in setting the terms of the credit. See 76 Fed. Reg. at 41,606-07.

8. Can model form H-3 be used for both real-estate-secured and non-real-estate secured loans?

No. Appendix H of Regulation V instructs that "each of the model forms is designated for use in a particular set of circumstances as indicated by the title of that model form." Model form H-3 is for real-estate-secured loans, and model form H-4 is for non-real-estate-secured loans.

9. If a lender routinely pulls credit reports but not credit scores and uses the reports to set terms materially less favorable, are risk-based pricing notices required?

Although credit scores are not being used, the lender is using information in a consumer report to set terms that are materially less favorable. In this circumstance, creditors are required to provide risk-based pricing notices. See §1022.72(a). Since the creditor is not using credit scores, the methods available to determine whether a consumer receives materially less favorable terms are the direct comparison or tiered pricing methods. See §1022.72(b) (direct comparison) and (b)(2) (tiered pricing). The lender can use either model form H-1 when credit is extended or H-2 after an account review. With respect to the credit score disclosure requirements imposed by the Dodd-Frank Act, because the lender did not rely on the credit score in setting the material terms of the credit, the creditor is not required to include a credit score in the risk-based pricing notice. See 76 Fed. Reg. at 41,606.

10. What range of credit scores should be disclosed in the credit score exception notices?

In the credit score exception notices, creditors are required to disclose the distribution of credit scores among consumers who are scored under the same scoring model that is used to generate the consumer's credit score using the same scale as that of the credit score provided to the consumer. This information must be presented as either:

- (a) a bar graph containing a minimum of six bars that illustrates the percentage of consumers with credit scores within the range of scores reflected in each bar; or
- (b) a clear and readily understandable statement informing the consumer how his or her credit score compares with the scores of other consumers.

See §1022.74(d)(1)(ii)(E) (requirements for residential mortgage consumer credit) and §1022.74(e)(1)(ii)(F) (requirements for nonresidential mortgage

consumer credit). As discussed in the preamble to the final rule, "If a credit score has a range of 1 to 100, the distribution must be disclosed using that same 1 to 100 scale. For a creditor using the bar graph, each bar would have to illustrate the percentage of consumers with credit scores within the range of scores reflected by that bar. A creditor would not be required to prepare its own bar graph; use of a bar graph obtained from the person providing the credit score that meets the requirements of this paragraph would be deemed compliant." See 75 Fed. Reg. 2,724, 2,741 (Jan. 15, 2010).

CONCLUSION

Subpart H of Regulation V (§§1022.70-75) contains the risk-based pricing notice requirements discussed in this article. In addition, on July 6, 2011, the Board and the FTC jointly issued final rules to implement the credit score disclosure requirements of §1100H of the Dodd-Frank Act for risk-based pricing notices.² Creditors must comply with these new credit score disclosure requirements, which apply to both risk-based pricing notices and adverse action notices, and implement appropriate controls to ensure compliance with these new rules as well as the existing risk-based pricing rules. Specific issues and questions should be raised with your primary regulator. 

² <http://1.usa.gov/dfa-credit-score> The Board separately updated the Regulation B model forms that combine the FCRA and the ECOA adverse action notices to reflect the new content requirements added by §1100F. The *Federal Register* notice is available at: <http://1.usa.gov/ecoa-forms>.

COMPLIANCE ALERT

FFIEC Announces Changes to Census Data Used for HMDA and CRA

On August 26, 2011, the Federal Financial Institutions Examination Council (FFIEC) announced that all Home Mortgage Disclosure Act (HMDA) and Community Reinvestment Act (CRA) data collected in 2012 must be geocoded using the new 2010 census tracts.¹ Data collected in 2011 and submitted in March 2012 will still be geocoded using the 2000 census tracts.

On a related note, on October 19, 2011, the FFIEC announced that the FFIEC census data file will incorporate data from the U.S. Census Bureau's American Community Survey (ACS). The FFIEC census data "are used to provide context to HMDA and Community Reinvestment Act (CRA) data."² According to the Census Bureau, the ACS is an ongoing survey that was fully implemented in 2005 after several years of testing. While the census data provide "counts of the population and their basic characteristics [such as] sex, age, race, Hispanic origin, and homeowner status," the

ACS data provide detailed "demographic, social, economic, and housing characteristics."³

The FFIEC will use the 2010 five-year ACS data to update its base file annually and will refresh the base file every five years. Historically, the FFIEC census base file was updated every 10 years. "Implementation of the new data for consumer compliance and CRA examination purposes will occur in 2012, and the data will be utilized in the same manner that decennial data has been used in the past. In addition to the tract income data, the new base file will include updated race and ethnicity data."⁴

Also on October 19, 2011, the FFIEC announced that it will calculate the annual median family income data that are published each June that were previously calculated by the Department of Housing and Urban Development. These data are also used for HMDA data compilation and CRA evaluations.

¹ <http://bit.ly/ffiec-census>

² <http://bit.ly/ffiec-acs>

³ <http://1.usa.gov/census-acs>

⁴ <http://bit.ly/ffiec-acs>

CONSUMER COMPLIANCE OUTLOOK – INDEX OF ARTICLES

REGULATION/STATUTE	ARTICLE	ISSUE
Regulation B (Equal Credit Opportunity Act)	Regulation B and Marital Status Discrimination: Are You in Compliance?	Q4 2008
Regulation C (Home Mortgage Disclosure Act)	Improving and Using HMDA Data in Your Compliance Program	Q4 2009
	Home Mortgage Disclosure Act (HMDA) and Community Reinvestment Act (CRA) Data Reporting: Question and Answers	Q2 2011
Regulation E (Electronic Fund Transfer Act)	Current Issues in Payroll Cards	Q4 2009
	Rules Regarding Overdraft Services: Questions and Answers	Q1 2010
Regulation H (Flood Disaster Protection Act of 1973)	Complex Issues in Flood Insurance Compliance	Q2 2008
	Flood Insurance Compliance Requirements	Q4 2011
Regulation X (Real Estate Settlement Procedures Act)	Escrow Accounting Rules: Are You in Compliance?	Q2 2009
	RESPA Changes to the Good Faith Estimate Form	Q2 2010
	RESPA Part II: Changes to the HUD-1 Form	Q3 2010
Regulation Z (Truth in Lending Act)	Disclosure Requirements for Reverse Mortgages	Q1 2010
	The Regulation Z Requirements for Open-End Credit Disclosures (Part One)	Q1 2009
	The Regulation Z Requirements for Open-End Credit Disclosures (Part Two)	Q2 2009
	New Regulation Z Rules Enhance Protections for Mortgage Borrowers	Q4 2008
	HELOCs: Consumer Compliance Implications	Q3 2008
	Reverse Mortgages and Consumer Protection Issues	Q3 2008
	Mortgage Disclosure Improvement Act of 2008 - Amendments to Regulation Z	Q3 2009
	An Overview of the Regulation Z Rules Implementing the CARD Act	Q1 2010
	Right of Rescission in Times of Foreclosure	Q2 2010
	The New Compliance Requirements Under Regulation Z for Private Education Loans	Q2 2010
	Mortgage Disclosure Improvement Act: Examples and Explanations	Q3 2010
	Payment Crediting Rules for Open-end credit, Credit Cards, and Closed-end Mortgage Payments	Q4 2010
	Mortgage Disclosure Improvement Act: Corrected Disclosure for an Over-stated APR	Q1 2011
	Loan Originator Compensation and Steering	Q1 2011
	The Federal Reserve Board's Interim Final Rule on Valuation Independence	Q3 2011
The New Dollar Threshold for Regulation Z Coverage	Q3 2011	

REGULATION/STATUTE	ARTICLE	ISSUE
Regulation AA (Unfair or Deceptive Acts or Practices)	Final Rules on Credit Card and Overdraft Practices (These rules were superseded by the CARD Act and its implementing regulations.)	Q1 2009
Regulation BB (Community Reinvestment Act)	Revisiting the Community Reinvestment Act	Q2 2009
	The Community Reinvestment Act and Minority-Owned Financial Institutions	Q4 2008
	Foreclosure Prevention Activities and the Community Reinvestment Act	Q2 2008
	CRA and Consumer Protection Issues in Banking Applications	Q1 2010
	The Community Reinvestment Act and HUD's Neighborhood Stabilization Program	Q4 2011
Regulation CC (Expedited Funds Availability Act)	Responding to Counterfeit Check Fraud	Q2 2008
Regulation DD (Truth in Savings Act)	GAO Issues Report on Bank Fees	Q3 2008
	Understanding Regulation DD's Advertising Requirements	Q4 2010
Servicemembers Civil Relief Act	Compliance Requirements for the Servicemembers Civil Relief Act	Q2 2011
	Servicemembers Civil Relief Act - Compliance Update	Q4 2011
Fair Credit Reporting Act	Affiliate Marketing Rules	Q4 2008
	Identity Theft Red Flags and Address Discrepancies	Q3 2009
	Furnisher Requirements Under the FACT Act "Accuracy and Integrity" Implementing Regulations	Q3 2010
Homeowner Affordability and Stability Plan	An Overview of the Home Affordable Modification Program	Q3 2009
E-Sign Act	Moving from Paper to Electronics: Consumer Compliance Under the E-Sign Act	Q4 2009
Other Topics	Managing Consumer Compliance Risks in Today's Economic Environment	Q1 2009
	Interview with Sandra Braunstein, Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System	Q2 2009
	The Bank Director's Role in Establishing a "Culture of Compliance"	Q3 2009
	Vendor Risk Management	Q1 2011
	Compliance Requirements for Young Consumers	Q2 2011

ADDRESS SERVICE REQUESTED

CALENDAR OF EVENTS

- | | | | |
|----------------|--|------------------|---|
| April 2012 | Regulatory Update Seminar Series
Federal Reserve Bank of Kansas City
This seminar will be offered in 10 different locations. Visit http://www.kc.frb.org/events/ for details. | April 24, 2012 | Interagency CRA Workshop
FRB Atlanta, FDIC, and OCC
Miami Branch of the Federal Reserve Bank of Atlanta
Miami, FL |
| April 5, 2012 | Small Business and Micro-Enterprise Development: Challenges and CRA Opportunities
FRB Atlanta, FDIC, and OCC
Federal Reserve Bank of Cleveland
Cleveland, OH | May 9-12, 2012 | Reinventing Older Communities: Building Resilient Cities
Federal Reserve Bank of Philadelphia and co-sponsors
Hyatt Penn's Landing Hotel
Philadelphia, PA |
| April 12, 2012 | Community Banker Forum
Federal Reserve Bank of Richmond
Baltimore Branch of the Federal Reserve Bank of Richmond
Baltimore, MD | June 10-13, 2012 | ABA Regulatory Compliance Conference
American Bankers Association
Walt Disney World Dolphin Hotel
Orlando, FL |
| April 19, 2012 | Community Bankers Conference
Federal Reserve Bank of New York
New York, NY | June 28-29, 2012 | Policy Summit: Housing, Human Capital, and Inequality
Federal Reserve Bank of Cleveland
InterContinental Cleveland Hotel
Cleveland, OH |