

# CONSUMER COMPLIANCE OUTLOOK®

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



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## COMPLIANCE RISKS FOR UNEARNED DISCOUNT POINTS

BY KELLY WALSH, SENIOR EXAMINER, FEDERAL RESERVE BANK OF SAN FRANCISCO

When pricing mortgage loans, many creditors offer borrowers the option of obtaining a lower interest rate by purchasing discount points. These points, paid in an upfront lump sum, lower the amount of interest paid over the life of the loan. Generally speaking, each discount point costs 1 percent of the total loan amount and usually lowers the interest rate by 25 basis points. For example, for a \$200,000 mortgage loan with a 5 percent par interest rate, two discount points would cost \$4,000 and would lower the interest rate by 50 basis points, to 4.50 percent.

Both borrowers and creditors potentially benefit from discount points. Borrowers gain the benefit of lower interest payments over the life of the mortgage, although the trade-off of an upfront payment in exchange for lower monthly payments involves a payback period and usually requires the borrower to retain the mortgage for a period of time to achieve a net gain. Discount points are also generally tax deductible.<sup>1</sup>

Creditors benefit by receiving a cash payment, which enhances their liquidity. However, creditors must ensure that discount points are not “unearned.” In other words, creditors must ensure that their mortgage loan officers do not engage in the practice of charging a fee for a service but failing to provide the service. The term unearned discount points describes points paid by borrowers that did not result in a reduction in the loan’s par interest rate.

Charging unearned discount points has compliance implications. This practice could violate the prohibition in section 5(a) of the Federal Trade Commission (FTC) Act against unfair or deceptive acts or practices (UDAP).<sup>2</sup> The practice could also have fair lending implications under the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA) if it has an illegal disparate impact. Discount points are also the focus of a recent rulemaking proposal under Regulation Z issued by the Consumer Financial Protec-

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<sup>1</sup> IRS Pub. 936 (Home Mortgage Interest Deduction), p. 5, available at: [www.irs.gov/pub/irs-pdf/p936.pdf](http://www.irs.gov/pub/irs-pdf/p936.pdf)

<sup>2</sup> 15 U.S.C. § 45(a). The Dodd-Frank Wall Street Reform and Consumer Protection Act added “abusive” to the UDAP lexicon, commonly referred to as UDAAP (unfair, deceptive, or abusive acts or practices). See 12 U.S.C. §5531. The CFPB has rulemaking authority under §5531 to identify specific unfair, deceptive, or abusive acts or practices. As of this date, it has not exercised that authority.

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# AN OVERVIEW OF THE NEW REGULATION E REQUIREMENTS FOR FOREIGN REMITTANCE TRANSFERS

BY KENNETH BENTON, SENIOR CONSUMER REGULATIONS SPECIALIST, FEDERAL RESERVE BANK OF PHILADELPHIA

The World Bank estimated that the global market for foreign remittance transfers, in which consumers electronically transfer funds to persons in another country, exceeded \$440 billion in 2010.<sup>1</sup> The United States ranked as the top transmitter in 2009, sending \$48.3 billion in transfers.<sup>2</sup> Many states have money transmitter laws and conduct examinations of transmitters through their state banking departments, but until the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), no federal consumer protection law directly regulated foreign remittance transfers.

During congressional hearings conducted before the Dodd-Frank Act was enacted, witnesses testified about consumer protection issues related to foreign remittance transfers. According to a report of the Senate Committee on Banking, Housing, and Urban Affairs, “[i]mmigrants send substantial portions of their earnings to family members abroad. These senders of remittance transfers are not currently provided with adequate protections under federal or state law. They face significant problems with their remittance transfers, including being overcharged or not having the funds reach intended recipients.”<sup>3</sup> The hearings suggested the need for reliable and standard disclosures, especially for the amount of the transfer the recipient would receive.<sup>4</sup>

In response to these concerns, Congress amended the Electronic Fund Transfer Act (EFTA) in section 1073 of the Dodd-Frank Act to add new EFTA section 919,<sup>5</sup> which creates four new compliance requirements for foreign remittance transfers. Section 919:

- Requires disclosures about important transaction terms, error resolution, and cancellation;
- Establishes error resolution procedures;
- Establishes cancellation and refund policies; and
- Establishes a remittance transfer provider’s liability for the acts of its agents.

In May 2011, the Federal Reserve Board (Board) published a rulemaking proposal to amend Regulation E and its Official Staff Commentary (Commentary) to implement section 919’s requirements.<sup>6</sup> Because the Dodd-Frank Act trans-

<sup>1</sup> *Migration and Remittances Factbook 2011*, second edition. World Bank, p. 19, available at: <http://siteresources.worldbank.org/INTLAC/Resources/Factbook2011-Ebook.pdf>.

<sup>2</sup> *Migration and Remittances Factbook 2011*, p. 15

<sup>3</sup> S. Rep. 111-176, at 179 (2010)

<sup>4</sup> The hearings and legislative history are discussed in the final rule for foreign remittance transfers. See 77 Fed. Reg. 6,194, 6,199 (Feb. 7, 2012).

<sup>5</sup> Dodd-Frank Act, section 1073. Section 919 of the EFTA is codified at 15 U.S.C. §1693o-1.

<sup>6</sup> 76 Fed. Reg. 29,902 (May 23, 2011)

ferred rulemaking authority for the EFTA from the Board to the Consumer Financial Protection Bureau (CFPB), effective July 21, 2011, the CFPB inherited the responsibility for completing the rulemaking.

In February 2012, the CFPB published the final rule, which largely adopted the Board's proposal.<sup>7</sup> The rule becomes effective February 7, 2013, and is codified as new subpart B to Regulation E, 12 C.F.R. §§1005.30-1005.36. The CFPB simultaneously issued a related rulemaking proposal to make changes to the final rule concerning transfers scheduled in advance and the definition of a remittance transfer provider, for which the CFPB solicited comments.<sup>8</sup> The CFPB published a final rule for the concurrent proposal on August 20, 2012.<sup>9</sup> This article reviews the final rules for foreign remittance transfers.

## DEFINITIONS

Before discussing the final rules, it is helpful to review several new definitions created in the February 2012 final rule:

- **Agent.** An agent, authorized delegate, or affiliate of the remittance transfer provider (as determined under state or applicable law) who, in connection with a foreign remittance transfer, acts for that remittance transfer provider.
- **Business day.** Any day on which the offices of a remittance transfer provider are open to the public for carrying on substantially all business functions.
- **Designated recipient (recipient).** A person the sender specifies and authorizes to receive a remittance transfer in a foreign country.
- **Preauthorized remittance transfer.** A remittance transfer authorized in advance to recur at substantially regular intervals.
- **Remittance transfer.** An electronic transfer of funds conducted by a remittance transfer provider at the request of a sender to a designated recipient. Small transfers in the amount of \$15 or less are excluded. Commodity and securities transfers, as defined in §1005.3(c)(4), are also excluded.
- **Remittance transfer provider (provider).** A person

who provides remittance transfers for a consumer in the normal course of its business, regardless of whether the consumer holds an account with such person.

- **Sender.** A consumer in a state who primarily for personal, family, or household purposes asks a provider to send a remittance transfer to a recipient.<sup>10</sup>

## COVERAGE

The final rule applies to providers, who are defined as persons providing remittance transfers to consumers in the normal course of business. To facilitate compliance, the CFPB established a bright-line safe harbor to determine when an institution makes transfers in the normal course of business. Specifically, the rule provides that a person who made 100 or fewer remittance transfers in the previous calendar year and continues to make 100 or fewer remittance transfers in the current year is deemed to not be providing remittance transfers in the normal course of business.<sup>11</sup>

The CFPB also established a transition period for providers who made fewer than 100 transfers in the previous year and then make over 100 in the current year. In that circumstance, once the provider exceeds 100 transfers in the current year and is determined to provide remittance transfers in the normal course of business, the provider has a reasonable period of up to six months to comply with the remittance transfer requirements in subpart B of Regulation E. See §1005.30(f)(2)(ii). The provider is not subject to subpart B compliance requirements for any remittance transfers made during the transition period. To facilitate compliance, Comment 30(f)-2.iv provides an example of the safe harbor and transition period.

While the bright-line rule creates a safe harbor, it does not preclude the possibility of a provider conducting more than 100 transfers per year without triggering a determination that it does so in the normal course of business. The Commentary provides further guidance on the meaning of "the normal course of business" with a facts and circumstances test:

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<sup>7</sup> 77 Fed. Reg. 6,194 (Feb. 7, 2012). The CFPB also published a technical correction to the final rule on July 10, 2012. 77 Fed. Reg. 40,459 (July 10, 2012).

<sup>8</sup> 77 Fed. Reg. 6,310 (Feb. 7, 2012)

<sup>9</sup> 77 Fed. Reg. 50,244 (Aug. 20, 2012)

<sup>10</sup> 12 C.F.R. §1005.30

<sup>11</sup> 12 C.F.R. §1005.30(f)(2)(i)

## NEWS FROM WASHINGTON: REGULATORY UPDATES\*

**Agencies release list of distressed or underserved nonmetropolitan middle-income geographies.** On June 29, 2012, the federal bank and thrift regulatory agencies announced the availability of the 2012 list of distressed or underserved nonmetropolitan middle-income geographies where revitalization or stabilization activities will receive Community Reinvestment Act (CRA) consideration as community development. These geographies are designated by the agencies in accordance with CRA regulations and reflect local economic conditions, including triggers such as unemployment, poverty, and population changes. The initial release of the 2012 list does not contain any tract information for certain areas. The 2011 lists should be used for those areas until the updated lists are released. The 2012 list will be updated when information becomes available sometime in late 2012. As with past releases, the agencies incorporate a one-year lag period for geographies that are no longer designated as distressed or underserved in the current release. Geographies subject to a one-year lag period are eligible to receive consideration for community development activities for 12 months after publication of the current list. The criteria for designating these areas are available on the Federal Financial Institutions Examination Council website ([www.ffiec.gov/cra](http://www.ffiec.gov/cra)).

**Banking agencies issue host state loan-to-deposit ratios.** On June 29, 2012, the Federal Reserve Board (Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) issued the host state loan-to-deposit ratios that the banking agencies will use in determining compliance with section 109 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. These ratios update data released on June 30, 2011. Section 109 prohibits a bank from establishing or acquiring a branch or branches outside its home state primarily for the purpose of deposit production and prohibits branches of banks controlled by out-of-state bank holding companies from op-

erating primarily for the purpose of deposit production. Section 109 also provides a process to test compliance with the statutory requirements. The first step in the process involves a loan-to-deposit ratio screen that compares a bank's statewide loan-to-deposit ratio with the host state loan-to-deposit ratio for banks in a particular state. The second step requires a banking agency to determine whether the bank is reasonably helping to meet the credit needs of the communities served by the bank's interstate branches. The second step is conducted if a bank's statewide loan-to-deposit ratio is less than one-half of the published ratio for that state or if data are not available at the bank to conduct the first step. A bank that fails both steps is in violation of section 109 and is subject to sanctions by the appropriate banking agency.

**Consumer Financial Protection Bureau (CFPB) launches consumer complaint database.** On June 19, 2012, the CFPB launched a public consumer complaint database for complaints about credit cards. It also released a snapshot of the complaints it has received about credit cards, mortgages, private student loans, and bank products through June 1, including six stories of consumers who filed complaints with the CFPB and successfully resolved their issues. The CFPB had asked the public to comment on a proposed policy of making some credit card complaint data publicly available, and after considering those comments, the CFPB has finalized its policy for disclosing some of the data through its consumer complaint database. The database allows the public to know the nature of the complaint and contains certain individual-level field data, including type of complaint, date of submission, consumer's zip code, and the company that the complaint concerns. The database also includes information about the actions taken on a complaint, whether the company's response was timely, how the company responded, and whether the consumer disputed the company's response. The database does not include confidential information about a consumer's identity. The database will be populated by credit card complaints received by the CFPB on and after June 1, 2012.



The CFPB will continue to publish reports containing aggregate data and analysis of all the complaints it receives. The CFPB published a notice in the *Federal Register* requesting comments on extending the database to financial products other than credit cards. The comment period closed on July 19, 2012.

**Agencies sign memorandum of understanding (MOU) on supervisory coordination.** On June 4, 2012, the Board, the CFPB, the FDIC, the National Credit Union Administration, and the OCC released an MOU that clarifies how the agencies will coordinate their supervisory activities, consistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Section 1025 of the Dodd-Frank Act requires the agencies to coordinate important aspects of their supervision of insured depository institutions with more than \$10 billion in assets and their affiliates. The agencies will coordinate the scheduling of examinations, conduct simultaneous examinations of covered depository institutions (unless an institution requests separate examinations), and share draft reports of examinations for comment. The MOU establishes coordination and cooperation between the CFPB and the other agencies, minimizes unnecessary regulatory burden, avoids duplication of effort, and decreases the risk of conflicting supervisory directives.

**CFPB reopened comment period on ability-to-repay rulemaking.** On May 31, 2012, the CFPB announced that it would reopen the comment period on the ability to repay and qualified mortgage proposal, which the Board proposed in May 2011. The proposal's comment period originally closed in July 2011, but the CFPB reopened it to seek comment on new data obtained after the comment period closed. The new comment period closed on July 9, 2012. The ability to repay and qualified mortgage proposal implements provisions of the Dodd Frank Act that require lenders to determine a consumer's repayment ability before making a loan. The proposal also addresses the definition

of qualified mortgages, which are loans deemed to satisfy the ability to repay requirement. The CFPB reopened the rulemaking for comment because it obtained data from the Federal Housing Finance Agency (FHFA) that tracked the performance of loans purchased or guaranteed by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation from 1997 to 2011. The CFPB also obtained data on other privately securitized mortgage loans. The notice explained that the CFPB could use this newly obtained data when defining a qualified mortgage. The notice specifically requested comment on the FHFA data and requested similar data regarding other types of mortgage loans and on the relationship between the ability-to-repay and other potentially relevant factors, such as borrowers' cash reserves. The notice did not reopen the comment period on other aspects of the ability-to-repay rulemaking. The CFPB expects to issue the final rule by January 21, 2013.

**CFPB seeks comment on prepaid cards.** On May 23, 2012, the CFPB issued an advance notice of proposed rulemaking seeking comment, data, and information about general-purpose reloadable prepaid cards (GPR cards) that allow consumers to load the cards with money upfront and use them as if they were checking account debit cards. The CFPB is interested in learning more about the costs, benefits, and risks to consumers and intends to issue a proposal to extend the protections of the Electronic Fund Transfer Act (EFTA) and Regulation E to GPR cards. Growth in the prepaid market has stemmed from consumers who are using a prepaid card as an alternative to a checking account. Despite the growth of prepaid cards, GPR cards have still not been subject to the EFTA. With the advance notice of proposed rulemaking, the CFPB plans to evaluate fees and terms of disclosure, unauthorized transactions, and product features. The comment period closed on July 22, 2012.

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

## ON THE DOCKET: RECENT FEDERAL COURT OPINIONS\*

### REGULATION X — REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

**The Supreme Court rules that RESPA's prohibition on unearned fees applies only to fees split between two or more parties.** *Freeman v. Quicken Loans, Inc.*, 132 S. Ct. 2034 (2012). The federal appeals courts have been divided over the requirements for a violation of RESPA section 8(b) for an unearned fee. Section 8(b) states that “[n]o person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service...other than for services actually performed.” Several courts have interpreted this language to mean that a section 8(b) violation occurs only when a settlement service provider shares a part of a fee with one or more persons who did nothing to earn that part. Other courts have held that all unearned fees for settlement services violate section 8(b), whether or not the fees are split. In *Freeman*, the Supreme Court reviewed a class-action lawsuit alleging an unearned fee violation because the plaintiffs were charged discount points to reduce their mortgage loan rates but claimed they did not receive rate reductions. In a unanimous decision, the court held that section 8(b) applies only to an unearned fee that is split between two or more persons. Because the plaintiffs did not allege that Quicken Loans split the discount fees with anyone else, the court affirmed the Fifth Circuit’s dismissal of the lawsuit.

It is important to note that while an unearned, undivided fee does not violate section 8(b) of RESPA, such a fee could still violate other consumer protection laws. This issue is discussed in detail in the article “Compliance Risks for Unearned Discount Points” on page 1.

### REGULATION Z — TRUTH IN LENDING ACT (TILA)

**The Fourth and Tenth Circuits issue conflicting decisions on whether a lawsuit is necessary to the timely exercise of the right of rescission.** *Gilbert v. Residential Funding LLC*, 678 F.3d 271 (4th Cir. 2012) and *Rosenfield v. HSBC Bank, USA*, 681 F.3d 1172 (10th Cir. 2012). In the Second Quarter issue, *Outlook* discussed the Ninth Circuit’s decision in *McOmie-Gray v. Bank of America Home Loans*, 667 F.3d 1325 (9th Cir. 2012), which held that to exercise the right of rescission in a timely manner, a borrower must file a lawsuit within three years of consummation and that sending written notice of rescission to the creditor during that period is insufficient to satisfy the three-year rescission period in section 1635(f) of TILA. (Ordinarily, a borrower has three business days after consummation to rescind the transaction, but if the creditor fails to provide notice of the right to cancel or the material disclosures, the period is extended to three years.)

The Fourth and Tenth Circuits have now addressed this issue with conflicting decisions. In *Gilbert*, the borrowers notified the lender within three years of consummation that they were exercising the right of rescission, but the lender rejected the request. The borrowers then filed a lawsuit, but it was more than three years after consummation. The Fourth Circuit held that the lawsuit was timely because the borrower had previously sent a written rescission notice to the creditor within three years of consummation. The court noted that the rescission provisions of TILA and Regulation Z do not require the filing of a lawsuit to exercise the right to rescind. Instead, Regulation Z states: “To exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication.” The court was careful to note, however, that it was not stating that a timely notice automatically rescinds a loan. For example, a borrower may be mistaken in his belief that he is entitled to rescind. If a creditor rejects a written request to rescind, a borrower would have to file a lawsuit to obtain a judicial determination, but the lawsuit would be timely if the written request had been made within three years of consummation.

The Tenth Circuit, on the other hand, held in *Rosenfield* that a borrower’s written rescission notice to the creditor within three years of consummation is not sufficient to exercise or preserve the right of rescission. The court, relying on the Supreme Court’s decision in *Beach v. Ocwen Federal Bank*, 523 U.S. 410 (1998), concluded that section 1635(f) of TILA requires borrowers to send written notice of rescission and file a lawsuit within three years of consummation. Because the borrower filed her lawsuit more than three years after consummation, the court affirmed the dismissal of the case.

### FAIR CREDIT REPORTING ACT (FCRA)

**Printing the last four digits of an account number, instead of the card number, on a receipt did not constitute an intentional FCRA violation justifying statutory and punitive damages.** *Van Straaten v. Shell Oil Prod. Co. LLC*, 678 F.3d 486 (7th Cir. 2012). The Seventh Circuit dismissed a class-action lawsuit against Shell Oil seeking punitive and



statutory damages for an alleged FCRA violation. The plaintiff purchased gasoline with a Shell credit card on which Shell designates the first nine digits as the “account number” and the last five as the “card number.” The receipt for the purchase displayed the last four digits of the account number rather than the last four digits of the card number. Under the Fair and Accurate Credit Transactions Act of 2003 (FACT Act), which amended the FCRA, merchants’ credit and debit card receipts cannot display a card’s expiration date or more than the last five digits of the card number. See 15 U.S.C. §1681c(g)(1). The plaintiff alleged that Shell violated the FACT Act by disclosing the wrong four digits; it should have disclosed the last four digits of the card number as outlined in the statute. The court concluded that regardless of whether Shell should have used the last four digits of the card number, the lawsuit should be dismissed because the plaintiff did not allege she suffered any damages. Instead, the lawsuit sought punitive and statutory damages, which are available only for a willful FCRA violation. Under *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47 (2007), a willful FCRA violation requires the showing of an objectively unreasonable interpretation of the FCRA. The court determined that Shell’s interpretation was not objectively unreasonable because the statute does not define “card number,” and consumers were not at greater risk for identity theft because Shell printed the last four digits of the account number rather than the last four digits of the card number.

**Court rejects challenge to risk-based pricing notice requirements for automobile dealers in third-party financing transactions.** *National Auto. Dealers Ass’n v. Federal Trade Commission*, 2012 WL 1854088 (D.D.C. 2012). A federal court in Washington, D.C. ruled against the National Automobile Dealers Association (NADA) in its lawsuit challenging a specific provision in the risk-based pricing regulations issued by the Federal Trade Commission and the Federal Reserve Board under the FACT Act. In multi-party credit transactions requiring a risk-based pricing notice, the regulation specifies that the person to whom the obligation is initially payable must provide the risk-based pricing notice, even if the obligation is immediately assigned after consummation. This frequently occurs in indirect auto lending when the dealer is the party whose name is on the credit agreement. NADA’s lawsuit argued that the FACT Act required the funding creditor that purchased the obligation to provide the notice. The FACT Act specifies that the person who “uses a credit report” must provide the risk-based pricing notice. The court concluded that the statute was ambiguous about the meaning of this phrase and deferred to the agencies’ interpretation, which the court found reasonable.

#### FAIR DEBT COLLECTION PRACTICES ACT (FDCPA)

**A loan servicer and loan assignee can be subject to the FDCPA if the loan was in default when acquired.** *Bridge v. Ocwen Fed. Bank, FSB*, 681 F.3d 355 (6th Cir. 2012). The Sixth Circuit reversed the dismissal of a lawsuit under the FDCPA against Ocwen, a loan servicer, and Deutsche Bank, which had purchased the loan. The lawsuit filed by a husband and wife, concerning a mortgage on which only the wife was liable, alleged that the defendants violated the FDCPA by attempting to collect payment when it was not in default and by attempting to collect the loan from the husband, who was not an obligor. At issue in the appeal was whether the defendants, who had not originated the loan, were debt collectors or creditors. The FDCPA generally does not apply to creditors. The court concluded that under the FDCPA, a person acquiring a loan or loan servicing rights is a debt collector if the loan was in default when acquired and a creditor if the loan was not in default. Because the plaintiffs alleged that the defendant treated the loan as if it were in default when it was acquired, the court held that the plaintiffs had stated a valid claim. The court also determined that the husband could have a claim under the FDCPA against the defendants for attempting to collect a debt he did not owe because the FDCPA covers consumers who are mistakenly alleged to have owed a debt. The case was remanded for further proceedings.

**The Eleventh Circuit rules that the FDCPA can apply in foreclosure proceedings.** *Reese v. Ellis, Painter, Ratterree & Adams, LLP* 678 F.3d 1211 (11th Cir. 2012). The Eleventh Circuit reversed the dismissal of a lawsuit against a law firm under the FDCPA. After the plaintiffs defaulted on a mortgage loan, a law firm representing the creditor sent them a dunning notice and threatened foreclosure unless the loan was satisfied. The plaintiffs alleged that the law firm’s communication violated the FDCPA because it contained deceptive and misleading representations. The lower court dismissed the case because it concluded that the law firm was enforcing a security interest, which does not constitute debt collection under the FDCPA. On appeal, the Eleventh Circuit reversed the decision because it determined that the law firm was both trying to enforce a security interest and attempting to collect a debt owed under the promissory note. For example, the law firm’s dunning letter stated: “Lender hereby demands full and immediate payment of all amounts due.... THIS LAW FIRM IS ACTING AS A DEBT COLLECTOR ATTEMPTING TO COLLECT A DEBT.” The case was remanded for further proceedings.

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

## COMPLIANCE RISKS FOR UNEARNED DISCOUNT POINTS

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tion Bureau (CFPB). This article discusses the compliance risks for creditors charging unearned discount points under the FTC Act, the ECOA, the FHA, and the CFPB's rulemaking proposal.

### DECEPTIVE ACT OR PRACTICE

Under the FTC Act, an act or practice is deceptive when (1) the representation, omission, or practice misleads or is likely to mislead the consumer, (2) the consumer's interpretation of the representation, omission, or practice is reasonable under the circumstances, and (3) the misleading representation, omission, or practice is material. See 15 U.S.C. §45(a).<sup>3</sup>

Charging unearned fees may be considered deceptive for the following reasons. First, by falsely representing on the HUD-1 Settlement Statement that points are discount points, a financial institution could mislead customers into believing they were receiving a discount off the par interest rate. When evaluating the facts, examiners could consider whether loan officers knew, prior to loan closing, what the interest rate deduction should have been relative to the discount points charged and whether borrowers were informed that either the discount fees would not result in a proportional discount in the interest rate or that no discount would be provided.

With respect to the second element of a deceptive act or practice, "The test is whether the consumer's expectations or interpretation are reasonable in light of the claims made."<sup>4</sup> If a financial institution represents to consumers that they can lower their mortgage loan rate by paying discount points, and those points are itemized on the final HUD-1 Settlement Statement, consumers may reasonably believe that the lender will provide an appropriately discounted interest rate.

Finally, the misrepresentation would be considered material if it concerned a sufficiently large amount of unearned fees or affected a large group of bor-

rowers. Claims made with the knowledge that they are false should be presumed to be material. For example, a financial institution's knowledge that fees disclosed as discount points on a HUD-1 Settlement Statement were not, in fact, resulting in a commensurate discount to borrowers would be presumed material.

While the practice of charging unearned discount points has the potential to violate section 5(a) of the FTC Act, it is important to emphasize that every UDAP case depends on its specific facts and circumstances.

### EQUAL CREDIT OPPORTUNITY ACT AND FAIR HOUSING ACT

Charging unearned discount points can also have fair lending implications. If a creditor charges discount points without actually lowering the rate and the practice has an illegal disparate impact, the practice could violate the ECOA, as implemented by Regulation B, and the FHA.

Regulation B prohibits discrimination against an applicant on a prohibited basis (race, color, religion, national origin, sex, marital status, age, receipt of public assistance, or exercising rights under the Consumer Credit Protection Act) regarding any aspect of a credit transaction. See 12 C.F.R. §1002.4(a). As explained in the Official Staff Commentary, the ECOA and Regulation B "may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face, unless the creditor's practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact."<sup>5</sup> Similarly, section 3605 of the FHA prohibits discrimination in residential real estate transactions because of race, color, religion, sex, handicap, familial status, or national origin.

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<sup>3</sup> The Federal Reserve Board and the Federal Deposit Insurance Corporation issued joint guidance on UDAP that discusses these requirements for the institutions they supervise. See *Unfair or Deceptive Acts or Practices by State-Chartered Banks* (March 11, 2004), available at: <http://bit.ly/udap-frb>. The Office of the Comptroller of the Currency has also issued UDAP guidance for the institutions it supervises: <http://bit.ly/udap-occ>. For institutions supervised by the CFPB, its examination manual discusses its approach to UDAP: <http://bit.ly/udap-cfpb>.

<sup>4</sup> *Unfair or Deceptive Acts or Practices by State-Chartered Banks*, p. 4.



Consider this example: A creditor provides its loan officers discretion in setting interest rates and discount points for borrowers. In some cases, loan officers charged borrowers discount points without a commensurate reduction in the note rate. A statistical analysis of the borrowers reveals that the practice had a disparate impact on Hispanic borrowers. Of the 100 Hispanic borrowers, 40 paid unearned discount points (40 percent). Of the 80 non-Hispanic white borrowers, 20 paid unearned discount points (25 percent). In other words, approximately 40 percent of the Hispanic borrowers paid unearned discount points, compared to 25 percent of non-Hispanic white borrowers. This difference is statistically significant at the 5 percent level.

If the creditor in this scenario cannot offer a legitimate business justification for these disparities, the practice could constitute a pattern or practice of credit discrimination in violation of the FHA, the ECOA, and Regulation B. Section 706(g) of the ECOA, 15 U.S.C. §1691e(g), mandates a referral to the U.S. Department of Justice when a federal banking agency has reason to believe that a creditor has violated section 701(a) of the ECOA by engaging in a pattern or practice of discrimination and provides discretionary referral authority for individual violations of section 701(a), 15 U.S.C. §1691(a).

#### OTHER LAW

In *Freeman v. Quicken Loans, Inc.*, 132 S. Ct. 2034 (2012), the U.S. Supreme Court recently narrowed considerably the circumstances in which an unearned fee will violate section 8(b) of the Real Estate Settlement Procedures Act (RESPA). The Supreme Court unanimously concluded, based on the statutory language, that a section 8(b) violation for an unearned fee must involve “a charge for settlement services [that] was divided between two or more persons.” Because the plaintiffs in *Freeman* did not allege that Quicken split discount points with anyone else, the court affirmed the dismissal of the case. It is important to note that while an unearned, undivided fee does not violate section 8(b) of RESPA, such a fee could still

violate the other consumer protection laws discussed earlier.

#### CFPB RULEMAKING PROPOSAL FOR DISCOUNT POINTS

On August 17, 2012, the CFPB issued a rulemaking proposal under Regulation Z to implement mortgage provisions in Title XIV of the Dodd-Frank Act, including a provision in section 1403 restricting discount points.<sup>6</sup> To protect consumers while allowing creditors to continue offering mortgages with discount points, the CFPB proposed two requirements for discount points. First, the consumer must be offered an alternative loan that does not include discount points and origination points or fees (unless the consumer is unlikely to qualify for the alternative loan). Second, the borrower must receive a bona fide reduction in the interest rate of the loan with discount points compared to the interest rate on the alternative loan without discount points.<sup>7</sup> Comments on the proposal are due by October 16, 2012. The CFPB expects to issue a final rule by January 21, 2013, as required by section 1400(c)(1) of the Dodd-Frank Act.

#### BEST PRACTICES FOR COMPLIANCE

Management should ensure that compliance and residential lending staff understand the risks associated with unearned discount points. Policies, procedures, and controls related to mortgage loan pricing should be sufficient to prevent loan officers from representing to borrowers that the rate was lowered because the borrowers purchased discount points without actually lowering the rate. A lender's pricing policy or guidelines should be specific and state that loan officers are prohibited from charging discount points that do not result in a proportional lowering of the interest rate.

#### CONCLUSION

Discount points may potentially provide significant benefit to both lenders and borrowers. However, charging unearned discount points can result in violations of laws and regulations and increased legal and reputational risks for financial institutions. Such


<sup>5</sup> Comment 6(a)-2

<sup>6</sup> 77 Fed. Reg. 55,272 (Sept. 7, 2012). The CFPB has also published a six-page summary of the proposal, which is available at: <http://bit.ly/CFPB-discount-points>.

<sup>7</sup> The restrictions on discount points appear in proposed 12 C.F.R. §1026.36(d)(2)(ii)(C).

violations could also result in required remediation to affected borrowers and other supervisory actions, including a possible referral to the U.S. Department of Justice if there is a fair lending violation.

To manage these risks and avoid potential violations associated with unearned discount points, lenders

should ensure that loan policies require that discount points are only charged when a commensurate discount to the rate is provided and systems are in place to ensure that practices are aligned with these policies. Specific issues and questions should be raised with your primary regulator. 

## COMPLIANCE ALERT

### Consumer Financial Protection Bureau (CFPB) proposes integrated RESPA/TILA mortgage application and closing disclosures.

On July 9, 2012, the CFPB issued a proposal to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) that direct the CFPB to combine the mortgage disclosures required by the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) into a single integrated disclosure.<sup>1</sup> The CFPB proposed a new three-page “Loan Estimate” disclosure that combines the early cost disclosure required under TILA and the Good Faith Estimate provided at application under RESPA. The CFPB also proposed a five-page “Closing Disclosure” to replace the final TILA disclosure and the HUD-1 form provided under RESPA at closing. This Closing Disclosure would summarize final loan terms and detail settlement costs of the transaction.

In addition, the CFPB proposed to include more costs in the disclosed finance charge and annual percentage rate (APR) for closed-end credit secured by real property or a dwelling under Regulation Z, including many costs currently excluded by statute. The broader definition of finance charge would result in more inclusive APRs for mortgage loans, which could increase the number of loans qualifying as high-cost loans under the Home Ownership and Equity Protection Act. To address this concern, the CFPB is also soliciting comment on a new benchmark, referred to as the Transaction Coverage Rate, or TCR, which creditors would use instead of the APR to determine if a loan is subject to the requirements for high-cost loans.<sup>2</sup> The definition of TCR would be less expansive than the proposed changes for finance charge.

The Dodd-Frank Act does not specify a deadline for finalizing the integrated mortgage disclosures, but it does require the CFPB to issue final rules to implement new mortgage disclosures that are required under Title XIV of the Dodd-Frank Act (Affected Title XIV Disclosures) no later than January 21, 2013. If the CFPB does not issue these final rules by January 21, 2013, the Affected Title XIV Disclosures become self-effectuating on that date. The CFPB believes that incorporating the Affected Title XIV Disclosures into the proposed integrated mortgage disclosures would benefit consumers and facilitate compliance. However, because of the complexity of the integrated mortgage disclosure rulemaking, the CFPB does not anticipate issuing a final rule by January 21, 2013. Thus, the CFPB proposed delaying the January 21, 2013 statutory deadline for the Affected Title XIV Disclosures until the rulemaking for the integrated mortgage disclosures is finalized.

The CFPB provided two comment periods for the proposal. Comments on the proposal to delay the effective date for the Affected Title XIV Disclosures were due by September 7, 2012. Comments on the proposed integrated mortgage disclosures, changes to the definition of finance charge, and the remainder of the proposal are due by November 6, 2012.<sup>3</sup>

For more information, including the rulemaking proposal, a summary of the proposal, and the new forms, please see the CFPB’s announcement at: <http://www.consumerfinance.gov/knowbeforeyouowe>.

<sup>1</sup> 77 Fed. Reg. 51,116 (Aug. 23, 2012)

<sup>2</sup> 77 Fed. Reg. 49,090 (Aug. 15, 2012)

<sup>3</sup> The CFPB originally proposed a September 7, 2012 deadline for commenting on the proposed finance charge changes but extended the deadline to November 6, 2012. See 77 Fed. Reg. 54,843 (Sept. 7, 2012).

## AN OVERVIEW OF THE NEW REGULATION E REQUIREMENTS FOR FOREIGN REMITTANCE TRANSFERS

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Whether a person provides remittance transfers in the normal course of business depends on the facts and circumstances, including the total number and frequency of remittance transfers sent by the provider. For example, if a financial institution generally does not make international consumer wire transfers available to customers, but sends a couple of international consumer wire transfers in a given year as an accommodation for a customer, the institution does not provide remittance transfers in the normal course of business. In contrast, if a financial institution makes international consumer wire transfers generally available to customers (whether described in the institution's deposit account agreement, or in practice) and makes transfers many times per month, the institution provides remittance transfers in the normal course of business.<sup>12</sup>

Providers who conduct more than 100 transfers per year but believe they are still exempt from the regulation should review the facts and circumstances test carefully to verify their eligibility for the exemption.

### DISCLOSURE REQUIREMENTS FOR PROVIDERS: §1005.31

When a sender requests a remittance transfer, the provider must deliver prepayment disclosures listing critical terms of the transaction and, if the consumer continues with the transaction after receiving the disclosures, a post-payment receipt that repeats the prepayment disclosures and includes additional information such as error resolution rights. The rule also includes an option to provide a combined disclosure prior to payment, in lieu of the prepayment disclosure and receipt.

#### *Prepayment Disclosures*

When a sender requests a remittance transfer, the provider must make seven disclosures (as applicable) in a retainable form before payment is made.<sup>13</sup> But if the

transaction is conducted orally or entirely by mobile telephone via mobile application or text message, the prepayment disclosures may be provided orally, by mobile application, or by text message, provided that the right of cancellation (discussed later in the article) is also disclosed either orally or by mobile application or text message.<sup>14</sup>

The seven prepayment disclosures must be made using the following terms (or substantially similar terms):<sup>15</sup>

1. **Transfer amount.** The amount that will be transferred to the recipient disclosed in the currency used to fund the remittance transfer.
2. **Transfer fees and transfer taxes.** Any fees and taxes imposed on the remittance transfer by the provider, disclosed in the currency used to fund the remittance transfer.
3. **Total.** The total amount of the transaction disclosed in the currency used to fund the remittance transfer. The total is calculated by adding the transfer amount, transfer fees, and transfer taxes.
4. **Exchange rate.** The rate used by the provider for the transfer, rounded to at least two and no more than four decimal places. A provider must round consistently for each currency.
5. **Transfer amount.** If other fees or taxes are imposed by someone other than the provider, the amount that will be transferred to the recipient disclosed in the currency in which the funds will be received by the designated recipient.
6. **Other fees and other taxes.** Any fees and taxes imposed on the remittance transfer by a person other than the provider, disclosed in the currency in which the funds will be received by the designated recipient.
7. **Total to recipient.** The amount the designated recipient will receive, disclosed in the currency in which the funds will be received by the designated recipient and based on the exchange rate used by the provider in Disclosure 4 prior to rounding.

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<sup>12</sup> Comment 30(f)-2.i

<sup>13</sup> 12 C.F.R. §1005.31(b)(1)

<sup>14</sup> 12 C.F.R. §1005.31(a)(5); Comment 31(a)(5)-1

<sup>15</sup> 12 C.F.R. §1005.31(b)(1)

Disclosures 1-3 show the sender the total cost of the transaction in the sender's currency (the amount the sender is transmitting plus any fees and taxes), while disclosures 5-7 show the breakdown of the net amount the recipient receives (the amount the sender transmitted less any applicable fees or taxes) in the currency in which the funds will be received. The exchange rate in Disclosure 4 is required to enable the sender to understand the conversion from the sender's currency to the recipient's currency. To facilitate compliance, Model Form A-30 shows a prepayment disclosure with all of the required terms. Model Form A-33 is similar except it does not show an exchange rate because it is based on a dollar-to-dollar transfer.

### Receipt

If a consumer continues with the transfer after receiving the prepayment disclosures, a receipt must be provided (generally when payment is made) that includes all of the prepayment disclosures and the following additional disclosures (using the following terms or substantially similar terms), as applicable:<sup>16</sup>

- The date on which funds will be available to the designated recipient in the foreign country, using the term Date Available. Providers are not permitted to use a range of dates. If the provider does not know the exact date, it may disclose the latest date by which funds will be available. It may also indicate that funds may be available sooner than the date disclosed using the term may be available sooner.
- The name and, if provided, the telephone number and/or address of the designated recipient, using the term Recipient.
- The statement about the sender's rights to resolve errors and cancel the transaction, using the language in Model Form A-37. If the transfer is scheduled by the sender at least three business days before the date of the transfer, the cancellation disclosure must reflect the requirements of §1005.36(c).
- The name, phone number, and website of the remittance transfer provider.
- A statement that the sender can contact the state agency that licenses or charters the remittance transfer provider and the CFPB for questions or complaints, using language set forth in Model

<sup>16</sup> 12 C.F.R. §1005.31(b)(2)

<sup>17</sup> 12 C.F.R. §1005.31(b)(3)

Form A-37. The disclosure must include the name, telephone number, and website of the state agency and the CFPB.

For transactions conducted by telephone, either orally or via mobile application or text message, the receipt may be mailed or delivered to the sender no later than one business day after payment. However, for telephone transactions, if payment was made by transferring funds from the sender's account held by the provider, the receipt may be provided on or with the next regularly scheduled periodic statement for that account or within 30 days after payment if no periodic statement is provided.

Model Form A-31 shows a receipt based on the same transaction used in the Model Form A-30 prepayment disclosure. Model Form A-34 is similar except it does not show an exchange rate because it is based on a dollar-to-dollar transfer.

### Combined Disclosure Option

To reduce the compliance burden, the final rule includes an option for providers to combine the prepayment disclosures and the receipt.<sup>17</sup> If a provider selects this option, it must provide the combined disclosure prior to payment. If the sender proceeds with the transaction after receiving the combined disclosure,

#### A-30 — Model Form for Pre-Payment Disclosures for Remittance Transfers Exchanged into Local Currency

<b>ABC Company</b>	
1000 XYZ Avenue Anytown, Anystate 12345	
Today's Date:	March 3, 2013
<b>NOT A RECEIPT</b>	
Transfer Amount:	\$100.00
Transfer Fees:	+\$7.00
Transfer Taxes:	+\$3.00
Total:	\$110.00
Exchange Rate:	US\$1.00 = 12.27 MXN
Transfer Amount:	1,227.00 MXN
Other Fees:	-30.00 MXN
Other Taxes:	-10.00 MXN
Total to Recipient:	1,187.00 MXN

the provider must deliver written or electronic proof of payment when the transaction is paid. The proof of payment may appear on the combined disclosure or a separate piece of paper.<sup>18</sup>

### Language Requirements

When disclosures are provided in a retainable form, providers have two compliance options for the languages used for the disclosures. The first option is to provide the disclosure in English and each of the foreign languages principally used by the provider to advertise, solicit, or market remittance transfers at the office at which a sender conducts a transaction or asserts an error.<sup>19</sup> For example, if the provider's office contains advertisements for remittance transfers in English, Spanish, and Vietnamese, providers could make disclosures in all three languages.

The second language disclosure option is to provide the disclosures in English and (if applicable) the foreign language primarily used by the sender to conduct business with the provider.<sup>20</sup> For example, if the sender requests the transfer in Spanish, providers could provide the disclosures in English and Spanish. But if the sender requests the transfer in English, only disclosures in English are required.<sup>21</sup> The Commentary for §1005.31(g) provides additional guidance on the language requirements, including a detailed discussion of the factors relevant to determining the language or languages a provider principally uses to advertise, solicit, or market remittance transfer services and the language primarily used by the sender with the remittance transfer provider to conduct the transaction or assert an error. For example, if a sender requests remittance transfer information from a provider in English about sending a remittance transfer to a person in Mexico, and the provider and the sender begin communicating in Spanish, Spanish is the language primarily used to conduct the transaction.<sup>22</sup> To facilitate compliance, some of the model forms show disclosures printed in Spanish.<sup>23</sup>

<sup>18</sup> Comment 31(b)(3)-1

<sup>19</sup> 12 C.F.R. §1005.31(g)(1)(i)

<sup>20</sup> 12 C.F.R. §1005.31(g)(1)(ii)

<sup>21</sup> Comment 31(g)-1.ii

<sup>22</sup> Comment 31(g)-2.i

<sup>23</sup> See Model forms A-38, A-39, A-40, and A-41.

## A-31 — Model Form for Receipts for Remittance Transfers Exchanged into Local Currency

### ABC Company

1000 XYZ Avenue  
Anytown, Anystate 12345

Today's Date: March 3, 2013

### RECEIPT

SENDER:

Pat Jones  
100 Anywhere Street  
Anytown, Anywhere 54321  
222-555-1212

RECIPIENT:

Carlos Gomez  
123 Calle XXX  
Mexico City  
Mexico

PICK-UP LOCATION:

ABC Company  
65 Avenida YYY  
Mexico City  
Mexico

Confirmation Code: ABC 123 DEF 456

Date Available: March 4, 2013

Transfer Amount:	\$100.00
Transfer Fees:	+\$7.00
Transfer Taxes:	+\$3.00
Total:	\$110.00

Exchange Rate: US\$1.00 = 12.27 MXN

Transfer Amount:	1,227.00 MXN
Other Fees:	-30.00 MXN
Other Taxes:	-10.00 MXN
Total to Recipient:	1,187.00 MXN

You have a right to dispute errors in your transaction. If you think there is an error, contact us within 180 days at 800-123-4567 or [www.abccompany.com](http://www.abccompany.com). You can also contact us for a written explanation of your rights.

You can cancel for a full refund within 30 minutes of payment, unless the funds have been picked up or deposited.

For questions or complaints about ABC Company, contact:

State Regulatory Agency  
800-111-2222  
[www.stateregulatoryagency.gov](http://www.stateregulatoryagency.gov)

Consumer Financial Protection Bureau  
855-411-2372  
855-729-2372 (TTY/TDD)  
[www.consumerfinance.gov](http://www.consumerfinance.gov)

## ESTIMATES: §1005.32

Disclosures must be accurate when the sender makes a payment.<sup>24</sup> However, because providers may not always be able to determine all of the transaction terms with certainty, the final rule permits the use of estimates for certain terms in two circumstances.

### *Temporary Exception for Depository Institution or Credit Union*

First, providers that are either an insured depository institution or a credit union may rely on estimates that are reasonably accurate when the exact amounts cannot be determined for reasons beyond their control.<sup>25</sup> This exception applies only to the disclosures for the exchange rate, taxes and fees imposed by other persons, the transfer amount (if taxes or fees are imposed by someone else), and the total amount transferred to the recipient. See 12 C.F.R. §1005.32(a)(1). The transfer must also be sent from the sender's account with the depository institution or credit union. The exception is temporary and scheduled to sunset on July 21, 2015; however, Congress authorized the CFPB to extend it by rule for five additional years if necessary to allow depository institutions and credit unions to continue offering foreign remittance transfers.<sup>26</sup>

The Commentary for §1005.32(a)(1) provides guidance and examples for determining whether disclosures are within the institution's control and whether estimates may be used under this exception. For example, if the exchange rate is determined when the funds are deposited in the recipient's account, and the institution does not have a correspondent relationship with the recipient's institution, estimates of the exchange rate are permitted.<sup>27</sup> Institutions should review the Commentary carefully to determine if they may rely on estimates for any of the required disclosed terms for which estimates are permitted.

This exception is important for the many depository institutions and credit unions that make foreign re-

mittance transfers using open-network systems such as wire transfers or international ACH. In an open-network system, the provider usually does not have a relationship with all of the intermediaries involved in completing the transaction. As a result, it may be difficult for an open-network provider to disclose certain terms, such as the fees imposed by an intermediary or the taxes imposed in the recipient's country.

This contrasts with a closed-network system, in which the provider has relationships with the other intermediaries involved in the transaction. For example, a Western Union remittance transfer initiated in the United States will likely be sent to the local Western Union office in the recipient's country. In a closed-network system, the provider can ascertain some of the transaction terms that must be disclosed from the other intermediaries with which it has a relationship.

### *Permanent Exception for Transfers to Certain Countries*

The second exception is permanent and applies to all providers. It permits estimates under two circumstances: 1) if a remittance transfer provider cannot determine the exact amounts when disclosure is required because of a recipient nation's laws; or 2) the methods by which transfers are made to a recipient nation do not permit providers to know the amount of currency to be received.<sup>28</sup> The latter circumstance based on transfer methods will apply only to international ACH on terms negotiated between the United States government and the recipient country's government, where the exchange rate is set by the central bank of the recipient country or other governmental authority on the business day after the provider has sent the remittance transfer.<sup>29</sup> The Commentary for §1005.32 provides helpful guidance for determining if either of the two exceptions applies.

To facilitate compliance, the CFPB announced in the final rule that it will establish a list of safe-harbor countries that qualify for the second exception. A provider can still

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<sup>24</sup> 12 C.F.R. §1005.31(f)

<sup>25</sup> 12 C.F.R. §1005.32(a)

<sup>26</sup> 12 C.F.R. §1005.32(a)

<sup>27</sup> Comment 32(a)(1)-2.i

<sup>28</sup> 12 C.F.R. §1005.32(b)(1)

<sup>29</sup> 77 Fed. Reg. at 6,245-46

use estimates for a country not on the list if the provider determined that the requirements of §1005.32(b)(1)(i) apply to the designated recipient's country, but the provider would not obtain a safe harbor.<sup>30</sup>

### *Methodology for Calculating Estimates*

It is important to note that if a provider relies on estimates, it must comply with the requirements in §1005.32(c) regarding the methodology to be used in calculating estimates for the exchange rate, the transfer amount in the recipient's currency, other fees and taxes, and the amount of currency the designated recipient will receive. The Commentary for §1005.32(c) provides further guidance on the methodology for calculating estimates. In addition, all estimates must be labeled as "Estimated" or a substantially similar term in close proximity to the disclosure. For example, a provider could label a disclosure as "Estimated Transfer Amount" or "Total to Recipient (Est.)." See Comment 31(d)-1.

### **ERROR RESOLUTION: §1005.33**

Because Congress created specific error resolution procedures for remittance transfers, the error resolution procedures in §1005.11 generally do not apply to remittance transfer providers. Instead, remittance transfer providers are generally governed by §1005.33 for error resolution purposes, with certain exceptions.

The following issues are subject to error resolution procedures:

- An incorrect amount paid by a sender unless the disclosure was an estimate and the difference results from application of the actual exchange rate, fees, and taxes, rather than any estimated amounts;
- A computational or bookkeeping error made by the provider;
- The failure to make funds available to a designated recipient in the amount of currency stated in the disclosure unless the disclosure was an estimate and the difference results from application of the actual exchange rate, fees, and taxes, rather than any estimated amounts, or the failure resulted

from extraordinary circumstances outside the provider's control that could not have been reasonably anticipated;

- The failure to make funds available to a designated recipient by the date stated in the disclosure unless the failure resulted from extraordinary circumstances outside the provider's control that could not have been reasonably anticipated; the delays resulted from the remittance transfer provider's fraud screening procedures or in accordance with the Bank Secrecy Act, the requirements of the Office of Foreign Assets Control, or similar laws or requirements; or the sender or person acting in concert with the sender acted with fraudulent intent; or
- The sender's request for documentation required by §1005.31 or for additional information or clarification concerning a remittance transfer, including a request a sender makes to determine whether an error exists under §1005.33(a)(1)(i) through (iv).

The Commentary provides additional guidance on errors. For example, if a designated recipient receives less than the amount the provider disclosed to the sender because the provider and the provider's agent in the foreign country used different exchange rates, an error has occurred.<sup>31</sup> Similarly, if the amount the designated recipient receives is less than the disclosed amount because of local taxes in the recipient's country or fees assessed by the provider's agent in the foreign country that were not disclosed, an error has occurred.<sup>32</sup> However, discrepancies resulting from the use of estimates do not qualify as errors unless the provider failed to use the methodology for making estimates in §1005.32(c).<sup>33</sup>

The Commentary clarifies the exception to the definition of error when providers fail to make funds available on the date specified on the receipt or combined disclosure because of extraordinary circumstances outside the provider's control that could not have been reasonably anticipated. The Commentary cites as examples "war or civil unrest, natural disaster, garnishment or attachment of the funds after the transfer is sent, and government actions or restrictions that could

<sup>30</sup> 12 C.F.R. §1005.32(b)(1)(ii)

<sup>31</sup> Comment 33(a)-3.i

<sup>32</sup> Comments 33(a)-3.ii and 33(a)-3.iii

<sup>33</sup> Comment 33(a)-3.v

not have been reasonably anticipated by the remittance transfer provider, such as the imposition of foreign currency controls.”<sup>34</sup>

The Commentary also clarifies the exception to the definition of error when an incorrect amount is received because of extraordinary circumstances outside the provider’s control that could not have been reasonably anticipated. The Commentary provides the following examples: “war or civil unrest, natural disaster, garnishment or attachment of some of the funds after the transfer is sent, and government actions or restrictions that could not have been reasonably anticipated by the remittance transfer provider, such as the imposition of foreign currency controls or foreign taxes unknown at the time the receipt or combined disclosure is provided.”<sup>35</sup>

The final rule also identifies sender requests that do not qualify as errors triggering error resolution procedures:

- An inquiry about the status of a remittance transfer, unless the funds from the transfer were not made available to a designated recipient by the disclosed date of availability;
- A request for information for tax or other record-keeping purposes;
- A change requested by the designated recipient; or
- A change in the amount or type of currency received by the designated recipient from the amount or type of currency stated in the disclosure provided to the sender if the provider relied on information provided by the sender.

If a provider determines that an error occurred, the sender must be offered the option of obtaining a refund or making the funds necessary to resolve the error available to the recipient. In addition, if the error involves a failure to make funds available on the date specified on the receipt or combined disclosure, the remittance transfer provider must also refund any

fees and (to the extent not prohibited by law) taxes imposed for the remittance transfer unless the sender provided incorrect or insufficient information to the remittance transfer provider.<sup>36</sup>

If a financial institution receives an error notice involving an incorrect electronic fund transfer from the sender’s account held by the institution and used to fund a remittance transfer, it must investigate under the Regulation E error procedures in §1005.11, provided the institution was not the remittance transfer provider.<sup>37</sup> However, if the institution is also the provider for the transaction, the §1005.33 procedures apply.<sup>38</sup>

### *Reasserting an Error*

If a provider completes an investigation that fully complies with the requirements of §1005.33, and the sender reasserts the error, the provider is not obligated to reinvestigate unless the error is asserted again after the provider responded to a sender’s request for documentation or for additional information or clarification concerning a remittance transfer.<sup>39</sup>

### *Unauthorized Remittance Transfers*

If a sender alleges an unauthorized electronic fund transfer for payment of a remittance transfer, the error resolution procedures in §§1005.6 and 1005.11 apply to the account-holding institution. For an alleged unauthorized use of a credit account to pay for a remittance transfer, the creditor must use the error resolution provisions in Regulation Z, 12 C.F.R. §1026.12(b), if applicable, and §1026.13.

### *Policies and Procedures and Record Retention*

Providers must establish policies and procedures to comply with the requirements of the remittance transfer regulations and retain records of senders’ error notices and documentation and the provider’s responses for at least two years.<sup>40</sup>

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<sup>34</sup> Comment 33(a)-6

<sup>35</sup> Comment 33(a)-4

<sup>36</sup> Comment 33(c)-2

<sup>37</sup> 12 C.F.R. §1005.33(f)(1)

<sup>38</sup> For transfers funded by an extension of credit, different rules apply. See 12 C.F.R. §1005.33(f)(2).

<sup>39</sup> 12 C.F.R. §1005.33(e)

<sup>40</sup> 12 C.F.R. §1005.33(g)



## CANCELLATION AND REFUND POLICIES: §1005.34

A sender generally has 30 minutes after payment to cancel the transaction, provided the recipient has not yet picked up the funds and the provider is able to identify the transaction to be cancelled.<sup>41</sup> Once a provider receives a valid cancellation request, it has three business days to refund the total amount of funds the sender provided, including fees and taxes (unless prohibited by law). The provider cannot impose fees for cancelling the transaction.<sup>42</sup>

## PROVIDER'S LIABILITY FOR THE ACTS OF ITS AGENTS: §1005.35

Because remittance transfers involve multiple parties and countries, Congress was concerned about the consumer's ability to redress errors caused by parties acting on behalf of a provider and included a provision in EFTA section 919(f) that makes providers liable for the acts of their agents, authorized delegates, or affiliates. The final rule implements this requirement in §1005.35 of Regulation E, under which a provider is liable for any violation of subpart B of Regulation E when an agent or authorized delegate acts on behalf of the provider. EFTA §919(f) also provides that a regulator enforcing compliance with these requirements may consider, when taking action against the provider, the extent to which the provider has policies and procedures in place, including procedures to exercise oversight of agents or authorized delegates acting on behalf of the provider.<sup>43</sup>

## TRANSFERS SCHEDULED IN ADVANCE: §1005.36

The compliance requirements for transfers scheduled in advance are slightly different with respect to the use of

estimates and cancellation. When a sender requests a single transfer or the first in a series of recurring transfers to occur at least five business days before a future transfer date, the provider may use estimates for certain terms in the prepayment disclosures and the receipt provided at the time of payment.<sup>44</sup> If a provider gives the consumer disclosures that include estimates under this exception, a second receipt with accurate figures must be provided generally no later than one business day after the transfer has been made.<sup>45</sup>

For each subsequent transfer in a series of recurring transfers, the provider need not deliver a prepayment disclosure. However, if certain information has changed with respect to what was disclosed with the first preauthorized remittance transfer, the provider must deliver a receipt within a reasonable period before the date of the transfer.<sup>46</sup> If estimates were provided or an updated receipt was unnecessary, the provider must deliver an accurate receipt no later than one business day after the transfer.<sup>47</sup>

With respect to the cancellation requirements, when transfers are scheduled at least three business days before transfer, senders may cancel the transfer if the provider receives the request at least three business days before the scheduled transfer. For single transfers scheduled at least three business days in advance or the first transfer in a series of preauthorized remittance transfers, the date of the transfer must be disclosed on the receipt.<sup>48</sup> For subsequent transfers, senders must also be informed of future transfer dates.<sup>49</sup>

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<sup>41</sup> 12 C.F.R. §1005.34(a)

<sup>42</sup> 12 C.F.R. §1005.34(b)

<sup>43</sup> An important legal issue raised by §1005.35 is the effect of the final rule on wire transfers covered by Article 4A of the Uniform Commercial Code (UCC). Article 4A establishes the legal framework for the rights and responsibilities of the parties to a wire transfer, including intermediaries. Article 4A does not apply to transactions covered by the EFTA, and remittance transfers will be governed by section 919 of the EFTA when the final rule becomes effective on February 7, 2013. Therefore, if a provider were held liable to the consumer under §1005.35 for an error committed by an agent, the provider could not look to the UCC to determine its rights against the agent. Other aspects of consumer remittance transfers previously governed by Article 4A are also affected. This issue is discussed in the final rule. See 77 Fed. Reg. at 6,211-12. In response to concerns about this issue for the Board's Fedwire transfers, the Board amended 12 C.F.R. §210.25 of its Regulation J to clarify that Article 4A applies to Fedwire transfers. As a result of this amendment, which became effective July 12, 2012, consumer remittance transfers conducted through Fedwire will still be subject to Article 4A unless there is a conflict with section 919 of the EFTA, in which case the EFTA will prevail. See 77 Fed. Reg. 21,854, 21,856 (April 12, 2012).

<sup>44</sup> 12 C.F.R. §1005.36(a)(1)(i)

<sup>45</sup> 12 C.F.R. §1005.36(a)(1)(ii)

<sup>46</sup> 12 C.F.R. §1005.36(a)(2)(i)

<sup>47</sup> 12 C.F.R. §1005.36(a)(2)(ii)

<sup>48</sup> 12 C.F.R. §1005.31(b)(2)(vii)

<sup>49</sup> 12 C.F.R. §1005.36(d)

## CONCLUSION

To implement the final rule, financial institutions will have to update their policies and procedures, training, and computer systems. Given the complexity of the changes, it is important that financial institutions start

the process early and rigorously test their systems for compliance. Specific issues should be discussed with the CFPB and your primary regulator. ©

### Additional Resources

*Report to the Congress on the Use of the Automated Clearinghouse System for Remittance Transfers to Foreign Countries* (July 2011). Available at: [http://www.federalreserve.gov/boarddocs/rptcongress/ACH\\_report\\_201107.pdf](http://www.federalreserve.gov/boarddocs/rptcongress/ACH_report_201107.pdf)

February 7, 2012 *Federal Register* notice for the final rule: <http://www.gpo.gov/fdsys/pkg/FR-2012-02-07/pdf/2012-1728.pdf>

July 10, 2012 *Federal Register* notice for a technical correction: <http://www.gpo.gov/fdsys/pkg/FR-2012-07-10/pdf/2012-16245.pdf>

August 20, 2012 *Federal Register* second final rule: [www.gpo.gov/fdsys/pkg/FR-2012-08-20/pdf/2012-19702.pdf](http://www.gpo.gov/fdsys/pkg/FR-2012-08-20/pdf/2012-19702.pdf)

*Small Business Compliance Guide*. The CFPB indicated in the final rules that it will be publishing a small business compliance guide for remittance transfers in the future.

## COMPLIANCE SPOTLIGHT

### Congress extends the National Flood Insurance Program and amends the National Flood Insurance Act and the Flood Disaster Protection Act.

On July 6, 2012, President Obama signed into law H.R. 4348, the Moving Ahead for Progress in the 21st Century Act. Title II of this law contains the Biggert-Waters Flood Insurance Reform Act of 2012 (the Biggert-Waters Act),\* which extends the National Flood Insurance Program (NFIP) until September 30, 2017, and amends the National Flood Insurance Act of 1968 (NFIA) and the Flood Disaster Protection Act of 1973 (FDPA). Some of the Biggert-Waters Act's provisions provide for the following changes:

- Increasing civil money penalties (CMPs) against regulated lending institutions with a "pattern or practice" of violating certain flood insurance requirements from \$385 to \$2,000 for each violation and removing the \$135,000 statutory cap on the amount of CMPs that may be assessed against an individual financial institution in a single calendar year.

The changes will likely result in significantly higher CMPs on financial institutions that are determined to have engaged in a pattern or practice of violations of the federal banking agencies' flood insurance regulations implementing the NFIA and the FDPA.

- Requiring lenders or servicers, within 30 days of receipt of a confirmation of the borrower's existing flood insurance coverage, to terminate force-placed insurance and refund any premiums paid by the borrower for the force-placed insurance (and any related fees charged to the borrower with respect to the force-placed insurance) during any period when both the borrower's policy and the lender's policy were in effect.
- Declining to extend subsidies for flood insurance, effective October 6, 2012, for policies issued or lapsed

\* Pub. L. 112-141, Div. F, Tit. II, Subtit. A

after July 6, 2012, and for certain existing policies covering:

- business properties;
  - residential properties that are not the owners' primary residence;
  - properties that have incurred substantial damage exceeding 50 percent of the fair market value of the property on or after July 6, 2012;
  - properties that have a substantial improvement exceeding 30 percent of the fair market value of the properties on or after July 6, 2012;
  - properties that have severe repetitive losses (as defined by the Biggert-Waters Act for single-family properties and by Federal Emergency Management Agency (FEMA) regulation for multi-family properties);
  - properties that have incurred flood-related damage in which the cumulative payments equaled or exceeded the fair market value of the property; or
  - prospective policyholders who refuse to accept offers of mitigation assistance from FEMA (including an offer to relocate) following a major disaster or in connection with a repetitive or severe repetitive loss property.
- Phasing in premium increases for policies losing subsidies described above, with increases capped at 25 percent per year until premiums equal the actuarial cost of the policies.
  - Increasing the annual limit on premium increases for other FEMA policies from 10 percent to 20 percent.
  - Requiring that any property located in an area participating in the NFIP will have the risk premium rate charged for flood insurance adjusted to reflect the current risk of flood, subject to any other provision of the act, and that any increase in the applicable rate will be phased in over a five-year period, at the rate of 20 percent for each year. If the area was not previously designated as having special flood hazards but becomes designated as having such an area, the risk premium rate for flood insurance purchased on or after July 6, 2012, for a property located in such an area shall be phased in over a five-year period, at the rate of 20 percent for each year.
  - Requiring each federal entity for lending regulation, including the Federal Reserve Board, to direct regulated lending institutions, by regulation (after consultation and coordination with the Federal Financial Institutions Examination Council) (FFIEC), to accept private flood insurance under certain circumstances.
  - Requiring federal agency lenders and the government-sponsored enterprises to accept private flood insurance policies under certain circumstances.
- Requiring lenders to disclose to borrowers that: (i) flood insurance is available from private insurance companies that issue standard flood insurance policies on behalf of the national flood insurance program or directly from the national flood insurance program; (ii) flood insurance that provides the same level of coverage as a standard flood insurance policy may be available from a private insurance company that issues policies on behalf of the company; and that (iii) the borrower is encouraged to compare the flood insurance coverage, deductibles, exclusions, conditions, and premiums associated with flood insurance policies issued on behalf of the national flood insurance program and policies issued on behalf of private insurance companies and to direct inquiries regarding the availability, cost, and comparisons of flood insurance coverage to an insurance agent.
  - Requiring each federal entity for lending regulation, including the Federal Reserve Board, to direct regulated lending institutions, by regulation (after consultation and coordination with the FFIEC), effective July 6, 2014, to establish escrows for flood insurance premiums unless the institution: (i) has total assets of less than \$1 billion; and on or before July 6, 2012, (ii) did not have a policy consistently and uniformly requiring the escrow of taxes, insurance premiums, fees, or any other charges; and (iii) was not required under federal or state law to deposit taxes, insurance premiums, fees, or any other charges into an escrow account. The preceding exceptions may not be applicable if state law requires the escrow of flood insurance premiums.
  - Authorizing FEMA to accept flood insurance premiums in installments for policyholders who are not required to escrow premiums.
  - Establishing a minimum deductible for property to which construction or substantial improvements occurred on or before December 31, 1974, or before the effective date of an initial flood insurance rate map of (i) \$1,500, if the flood insurance coverage for such structure covers loss or damage in an amount equal to or less than \$100,000, and (ii) \$2,000, if the flood insurance coverage for such structure covers loss or damage in an amount greater than \$100,000.
  - Establishing a minimum deductible for property to which construction or substantial improvements occurred after December 31, 1974, or after the effective date of an initial flood insurance rate map of (i) \$1,000, if the flood insurance coverage for such structure covers loss or damage in an amount equal to or less than \$100,000, and (ii) \$1,250, if the flood insurance coverage for such structure covers loss or damage in an amount greater than \$100,000.

**ADDRESS SERVICE REQUESTED**

## CALENDAR OF EVENTS

- |                                  |  |
|----------------------------------|--|
| October 22-23, 2012              | <b>Annual Payments Conference</b><br>Federal Reserve Bank of Chicago<br>Chicago, IL  |
| October 25-26, 2012              | <b>Promising Pathways To Wealth-Building Financial Services</b><br>Federal Reserve Bank of St. Louis<br>St. Louis, MO  |
| October 29-30, 2012              | <b>RAISE Texas Training and Summit: Providing the Tools for Financial Stability</b><br>Federal Reserve Bank of Dallas (Houston Branch)<br>Houston, TX  |
| October 31 -<br>November 2, 2012 | <b>Annual Development Banking Conference: Responsible Banks, Strong Communities</b><br>National Community Investment Fund<br>JW Marriott<br>Chicago, IL  |
| November 9, 2012                 | <b>Annual Community Bankers Symposium</b><br>FRB Chicago, FDIC, and OCC<br>Federal Reserve Bank of Chicago (attendance limited to 7th District community bankers, banking trade associations, and regulators)<br>Chicago, IL |