

CONSUMER COMPLIANCE OUTLOOK[®]

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



Smartphone interactive scan

PERSPECTIVES ON CONSUMER PROTECTION: A CONVERSATION WITH GOVERNOR DUKE

For the fifth anniversary issue of *Consumer Compliance Outlook*, staff asked Governor Elizabeth A. Duke for her perspectives on consumer protection and consumer compliance issues.

1. What do you see as the most effective approach to consumer compliance and consumer compliance supervision?

In thinking about successful consumer compliance supervision, I often draw on my experience running a community bank in the first part of my career. The success of my company was dependent on the beneficial relationships we maintained with our customers. As a small bank, we had limited resources that challenged us when it came to meeting all the regulatory requirements associated with delivering financial services to those customers. But we discovered that if we built compliance into the everyday aspects of our bank's operations, we could reduce the burden of compliance. Institutions that treat compliance controls as an overlay — to be performed after the fact or fixed when the auditor comes through — miss the boat. These institutions incur much higher compliance costs and find that the expense associated with maintaining compliance discourages the offering of new products and services. The institution that operationalizes a culture of compliance functions much more efficiently and is able to provide a good variety of services to fulfill its customers' financial needs.

So, how can compliance examiners' activities foster this culture of compliance? In my view, the way we communicate our concerns to institutions can guide them either toward the model of "compliance as a check box" or toward the model of "compliance as part of the way business is done." If our discussions with our supervised institutions focus on enumerating violations found, management's response will be limited to correction of those violations after the fact. This kind of "gotcha" mentality only brings about temporary corrections of problems in isolation. A traffic ticket is only effective in slowing the speeder until the next time he or she is late for an appointment. If, instead, the conversation is centered on the big picture of compliance with clear communication of expectations, the result is a more enduring compliance structure balanced with the size and complexity of the institution itself. Our communications with bank management should be aimed at facilitating the bank getting it right. When exit meeting conversations address break-

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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 October 17, 2012, the Federal Reserve Board (Federal Reserve), on behalf of the Non-Discrimination Working Group of the Financial Fraud Enforcement Task Force, conducted an *Outlook Live* webinar titled "Fair Lending 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 questions most frequently asked during the webinar as well as other questions that we have recently received.

FAIR LENDING EXAMINATIONS

1. What efforts is the Federal Reserve undertaking to improve the efficiency of the fair lending examination process, particularly for community banks?

The Federal Reserve 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. Some community banks have raised concerns about whether fair lending matters are evaluated consistently across the Federal Reserve System and have noted difficulty understanding the statistical analysis. We take these concerns seriously and have taken several steps to address them.

In 2009, in conjunction with the other federal banking agencies, the Federal Reserve revised the Interagency Fair Lending Examination Procedures (the Procedures) to provide more detailed information regarding current fair lending risk factors and to ensure that our examination procedures keep pace with industry changes. The Procedures are available to banks to aid in their analysis of fair lending risks and to prepare for fair lending examinations. Moreover, examiners work closely with the Board's Fair Lending Enforcement Section when they find evidence of potential discrimination. This process ensures that fair lending laws and regulations are enforced consistently and rigorously throughout the Federal Reserve System.

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 the electronic data we obtain

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

¹ An archived version of the webinar is available at: tinyurl.com/2012-fair-lending. 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 Federal Reserve.

from banks to determine if there are any disparities in lending on a prohibited basis. We find that these reviews are very effective and more efficient for both banks and examiners. In most cases, our statistical analyses do not identify concerns. When we find problems, we take additional steps to communicate with the banks to ensure they understand the fair lending concerns raised by the analysis and how to respond effectively.

Finally, the Federal Reserve engages in a variety of outreach activities to ensure that banks of all sizes have access to information about the Federal Reserve's approach to fair lending examinations. For example, this webinar had more than 5,000 registrants, most of whom were from community banks. The Fair Lending Enforcement staff meets regularly with consumer advocates, representatives of supervised institutions, and industry representatives to discuss fair lending matters and receive feedback. Through this outreach, the Federal Reserve addresses emerging fair lending issues and promotes sound fair lending compliance.

2. What is the difference between the fair lending supervisory authority of the Federal Reserve and the Consumer Financial Protection Bureau (CFPB)?

The Federal Reserve and the CFPB have different supervisory authority for the fair lending laws, depending on the asset size of the institution. Pursuant to provisions of the Dodd-Frank Act, effective July 21, 2011, the CFPB supervises state member banks with assets of more than \$10 billion for compliance with the Equal Credit Opportunity Act (ECOA), while the Federal Reserve retains supervisory authority for those institutions for compliance with the Fair Housing Act (FHA). For state member banks with assets of \$10 billion or less, the Federal Reserve retains the authority to enforce both the ECOA and the FHA.

The ECOA prohibits creditors from discriminating against any applicant, in any aspect of a credit transaction, on the basis of race, color, religion, national origin, sex, marital status, or age. In addition, creditors may not discriminate against an applicant because the applicant receives income from a public assistance program or has exercised, in good faith, any right under the Consumer Credit Protection Act. See 15 U.S.C. §1691(a). The FHA prohibits discrimination

in residential real estate–related transactions, including the making and purchasing of mortgage loans, on the basis of race, color, religion, sex, handicap, familial status, or national origin. See 42 U.S.C. §3605(a).

REDLINING

3. What factors does the Federal Reserve consider in a redlining review?

Consistent with the Procedures, the Federal Reserve considers several risk factors in a redlining review, including:

- *Community Reinvestment Act (CRA) Assessment Area/Market Area.* Assessment areas or market areas that appear to exclude census tracts on a prohibited basis.
- *Lending Record.* A record of Home Mortgage Disclosure Act (HMDA) mortgage lending and/or CRA small business lending that shows statistically significant disparities on a prohibited basis when compared with similar lenders in the reasonably expected market area.
- *Branching Strategy.* A branching strategy that appears to exclude census tracts on a prohibited basis.
- *Marketing and Outreach Strategy.* A marketing and outreach strategy that appears to treat census tracts differently on a prohibited basis.
- *Complaints.* Any complaints raised by consumers or consumer advocates indicating that the bank treats certain geographies differently on a prohibited basis.

For all of these factors, the Federal Reserve will take into account any changes based on the updated 2010 Census data.

In 2011, the U.S. Department of Justice (DOJ) settled two redlining cases based on referrals from the Federal Reserve: *United States v. Citizens Republic Bancorp, Inc.*, and *United States v. Midwest BankCentre*. Both cases are available at: www.justice.gov/crt/about/hce/caselist.php#lending.

4. How does the Federal Reserve evaluate a bank's lending record during a redlining examination?

Generally, the Federal Reserve evaluates a bank's HMDA data relative to similar lenders in the bank's CRA assessment area or reasonably expected market

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ADVERSE ACTION NOTICE REQUIREMENTS UNDER THE ECOA AND THE FCRA

BY SARAH AMMERMANN, EXAMINER, FEDERAL RESERVE BANK OF MINNEAPOLIS

INTRODUCTION

Two federal laws — the Equal Credit Opportunity Act (ECOA), as implemented by Regulation B, and the Fair Credit Reporting Act (FCRA) — reflect Congress's determination that consumers and businesses applying for credit should receive notice of the reasons a creditor took adverse action on the application or on an existing credit account.¹ Notice is also required under the FCRA for adverse actions taken with respect to insurance transactions, employment decisions, and in certain other circumstances.

The two laws serve different purposes. Adverse action notices under the ECOA and Regulation B are designed to help consumers and businesses by providing transparency to the credit underwriting process and protecting against potential credit discrimination by requiring creditors to explain the reasons adverse action was taken. The FCRA's requirements for adverse action notices apply only to consumer transactions and are designed to alert consumers that negative information was the basis for the adverse action. Under the FCRA, the consumer has 60 days from the date of the notice to obtain more details about the negative information so that if it is erroneous, the consumer can correct it. To reduce the compliance burden, a creditor can use a single, combined notice to comply with the adverse action requirements of both laws, and model forms have been published in connection with Regulation B.

To ensure compliance, it is important to understand how the requirements of Regulation B and the FCRA relate to and differ from one another. In this article, we review the adverse action requirements of both Regulation B and the FCRA, explain recent disclosure requirements under the FCRA mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), and discuss common adverse action violations.

WHAT IS ADVERSE ACTION?

Regulation B defines adverse action as:

- A refusal to grant credit in substantially the amount or on substantially the terms requested in an application unless the creditor makes a counteroffer (to grant credit in a different amount or on other terms), and the applicant uses or expressly accepts the credit offered;
- A termination of an account or an unfavorable change in the terms of an account that does not affect all or substantially all of a class of the creditor's accounts; or
- A refusal to increase the amount of credit available to an applicant who has made an application for an increase.²

To provide greater clarity about the definition, Regulation B also specifically delineates what is *not* adverse action:

- A change in the terms of an account expressly agreed to by an applicant;
- Any action or forbearance relating to an account taken in connection with inactivity, default, or delinquency as to that account;
- A refusal or failure to authorize an account transaction at point of sale or loan except when the refusal is a termination or an unfavorable change in the terms of an account that does not affect all or substantially all of a class of the creditor's accounts or when the refusal is a denial of an application for an increase in the amount of credit available under the account;
- A refusal to extend credit because applicable law prohibits the creditor from extending the credit requested; or
- A refusal to extend credit because the creditor does not offer the type of credit or credit plan requested.³

The FCRA, by contrast, defines adverse action more broadly to include:

¹ There are no implementing regulations for the adverse action requirements in the FCRA.

² 12 C.F.R. §1002.2(c)(1)

- Adverse action as defined in section 701(d)(6) of ECOA;
- A denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of, any insurance, existing or applied for, in connection with the underwriting of insurance;
- A denial of employment or any other decision for employment purposes that adversely affects any current or prospective employee;
- A denial or cancellation of, an increase in any charge for, or any adverse or unfavorable change in the terms of a government license or benefit; or
- An action on an application or transaction initiated by a consumer, or in connection with account review that is adverse to the consumer's interests.⁴

Thus, the FCRA definition not only specifically includes the ECOA definition but also covers certain noncredit, consumer-initiated transactions and applications, including consumer applications for insurance, employment, a rental, and a government license or benefit. Note, however, that the FCRA only applies to consumer transactions, so adverse action notices are not required under the FCRA for business transactions.

When Is Notice Required?

Generally, Regulation B notice requirements are trig-

Table 1: When Adverse Action Notices Are Required

Regulation B (Consumer and Business)	FCRA (Consumer)
<p>A creditor must provide notice if it has:^a</p> <ul style="list-style-type: none"> • Taken adverse action on a completed credit application; • Taken adverse action on an incomplete credit application; • Taken adverse action on an existing credit account; or • Made a counteroffer to an application for credit and the applicant does not accept the counteroffer.^b <p>Notice is not required if:</p> <ul style="list-style-type: none"> • The transaction does not involve credit; • A credit applicant accepts a counteroffer; • A credit applicant expressly withdraws an application; or • The creditor approves a credit application and both parties expect that the applicant will inquire about its status, but the applicant does not inquire within 30 days after application^c (the approved application is treated as withdrawn). 	<p>For a covered transaction, a person must provide notice if:</p> <ul style="list-style-type: none"> • Adverse action was taken based in whole or in part on information in a consumer report^d; • Consumer credit is denied or a charge for credit increased based on information obtained from third parties other than consumer reporting agencies bearing upon the consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living^e; or • Adverse action was taken based on information furnished by a corporate affiliate of the person taking the action.^f
<p>^a 12 C.F.R. §1002.9(a)(1)</p> <p>^b A creditor can provide a combined counteroffer and adverse action notice. The creditor would not have to send a separate adverse action notice if the counteroffer is not accepted. See Comment 9(a)(1)-6 of the Official Staff Commentary for Regulation B.</p> <p>^c 12 C.F.R. §1002.9(e)</p> <p>^d FCRA section 615(a)</p> <p>^e FCRA section 615(b)(1)</p> <p>^f FCRA section 615(b)(2)</p>	

gered when adverse action is taken on a credit application or an existing credit account, and FCRA notice requirements are triggered when adverse action is taken based on information provided in one of the three circumstances listed in Table 1 in the FCRA column.

Because of different coverage rules, an adverse action notice may be required under one law but not the

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³ 12 C.F.R. §1002.2(c)(2)

⁴ FCRA section 603(k)(1). The last bullet concerning consumer-initiated transactions and applications is often referred to as a catch-all provision and was added to the FCRA in 1996 to overturn an FTC interpretation that stated that refusal to accept payment by check or rent an apartment based on a consumer report did not require an adverse action notice under the FCRA. See H.R. Rep. No. 103-486 at 26 (1994).

Consumer Financial Protection Bureau (CFPB) issues report on payday lending and deposit advance loans. On April 24, 2013, the CFPB issued a report on payday lending and deposit advance loans. The report was based on data from more than 15 million storefront payday loans and depository institutions that offer deposit advance products. The report notes that both products are designed to address a cash flow shortage for consumers between paychecks or receipt of other income. The report found that these transactions generally have three features: they are issued in small-dollar amounts, must be repaid quickly, and require a borrower to repay the full amount or give lenders access to repayment through a claim on the borrower's deposit account. A key finding of the report is that because repayment is required within a short time (typically 14 days), rollovers are often necessary, making the transactions costly and burdensome for consumers. The CFPB report also notes that the loans usually involve little or no underwriting. As a result, the CFPB found that these transactions often evolve into expensive, long-term loans. The CFPB's report is available at: tinyurl.com/payday-report. The CFPB also issued a fact sheet about this type of lending, which is available at: tinyurl.com/pd-facts.

CFPB issues small entity compliance guide for ability-to-repay and qualified mortgage rule. On April 10, 2013, the CFPB issued a compliance guide for its recent final rule implementing the ability-to-repay and qualified mortgage provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The CFPB's guide, which was issued pursuant to the requirements of the Small Business Regulatory Enforcement Fairness Act of 1996, is available at: tinyurl.com/qm-atr. When the compliance guide was published, the CFPB had a rule-making proposal pending to amend the rule to address certain issues raised by the industry. Subsequently, on May 29, 2013, the CFPB published the final rule for the proposed amendments.

CFPB issues bulletin on indirect auto lending. On March 21, 2013, the CFPB issued Bulletin 2013-02 to provide guidance on compliance with the Equal Credit Opportunity Act (ECOA) for indirect auto lenders under the CFPB's jurisdiction. Such lending occurs when a motor vehicle dealer finances a consumer's purchase after confirming the terms on which the indirect lender is willing to purchase the credit contract from the dealer. The CFPB's guidance focuses on the indirect lender's practice of providing the dealer with a minimum "buy rate" for loans meeting preestablished underwriting criteria. Lenders generally allow dealers to increase the interest rate above the "buy rate" and agree to share a portion of the additional compensation with the

dealer. The CFPB's guidance concentrates on indirect lenders' potential liability under ECOA if dealer markups result in discriminatory pricing disparities.

The CFPB's guidance notes that an indirect auto lender is a "creditor" under ECOA and Regulation B if it participates in the credit decision and that the standard practices of indirect auto lenders likely constitute participation in the credit decision, stating: "For example, an indirect auto lender is likely a creditor under the ECOA when it evaluates an applicant's information, establishes a buy rate, and then communicates that buy rate to the dealer, indicating that it will purchase the obligation at the designated buy rate if the transaction is consummated. In addition, when a lender provides rate sheets to a dealer establishing buy rates and allows the dealer to mark up those buy rates, the lender may be a creditor under the ECOA when it later purchases a contract from such a dealer. These two examples are illustrative of common industry practices; indirect auto lenders may also be creditors under other circumstances." The CFPB's bulletin states that if dealer markups and lender compensation practices result in pricing disparities for protected-class borrowers, lenders could be liable under the legal doctrines of disparate treatment and disparate impact. To mitigate this risk, the bulletin recommends:

- imposing controls on dealer markup and compensation policies or otherwise revising dealer markup and compensation policies and monitoring and addressing the effects of those policies to address unexplained pricing disparities on prohibited bases; or
- eliminating dealer discretion to mark up buy rates and fairly compensating dealers using another mechanism, such as a flat fee per transaction, that does not result in discrimination.

The bulletin also discusses the features of a strong fair lending compliance program and best practices. The bulletin is available at: tinyurl.com/cfpb-indirect-auto.

Agencies release proposed revisions to Interagency Questions and Answers regarding community reinvestment. On March 18, 2013, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency requested comment on proposed revisions to Interagency Questions and Answers (Q&As) that provide additional guidance on the agencies' Community Reinvestment Act (CRA) regulations. The proposed revisions focus primarily on community development, which is considered as part of the CRA performance tests for large institutions, intermediate small institutions, and wholesale and limited purpose institutions. Small institutions may use community development activity to receive consideration toward an outstanding CRA rating.



The proposed amendments are intended to 1) clarify how the agencies consider community development activities that benefit a broader statewide or regional area that includes an institution's assessment area; 2) provide guidance related to CRA consideration of, and documentation associated with, investments in nationwide funds; 3) clarify the consideration of certain community development services; 4) address the treatment of qualified investments with organizations that use only a portion of the investment to support a community development purpose; and 5) clarify that community development lending should be evaluated in such a way that it may have a positive, neutral, or negative impact on the large institution lending test rating. The comment period closed on May 17, 2013. The press release is available at: www.federalreserve.gov/newsevents/press/bcreg/20130318a.htm.

CFPB takes first step to develop a student loan affordability plan. On February 21, 2013, the CFPB announced it was collecting information to develop policy options that would make repayment of private student loans more manageable for borrowers struggling with repayment. The Dodd-Frank Act created the position of private education loan ombudsman in the CFPB and requires the ombudsman to compile and analyze data on borrower complaints regarding private education loans and to make appropriate recommendations to the CFPB's director, the secretary of the Treasury, the secretary of education, and Congress. The CFPB has found that borrowers with high payments lack alternative repayment and refinance options. The information being collected will help the CFPB make recommendations to policymakers on how to restructure student loan repayments to assist borrowers who are having difficulties. The CFPB sought input on a variety of issues related to repayment affordability, including 1) how student loan burdens might impact the broader economy and hinder access to mortgage credit and automobile loans, 2) how distressed borrowers manage their student loan obligations, 3) what options currently exist for borrowers to lower their monthly payments on private student loans, 4) examples of successful alternate payment programs in other markets and which features could apply to student loans, and 5) the most effective mechanisms for communicating with distressed borrowers. The comment period closed April 8, 2013. The announcement is available at: tinyurl.com/cfpb-student.

CFPB establishes implementation plan for new mortgage rules. On February 13, 2013, the CFPB announced its plan to help facilitate the mortgage industry's compliance with new mortgage regulations that become effective in January 2014. The CFPB issued the regulations

in January 2013 to implement provisions in Title XIV of the Dodd-Frank Act. The mortgage rules include new requirements concerning underwriting standards, originator compensation, appraisals, escrow accounts, loan servicing, and high-cost mortgages. To support implementation of the new regulations, the CFPB will 1) coordinate with other agencies, 2) publish plain-language guides, 3) publish updates to its official interpretations, 4) publish readiness guides for the industry, and 5) promote consumer education. The press release is available at: tinyurl.com/cfpb-mortgage-plan. The CFPB has also created a mortgage resource web page, which is available at: tinyurl.com/cfpb-implement.

CFPB to monitor mortgage transfer activity at bank and nonbank servicers. On February 11, 2013, the CFPB issued a bulletin regarding the legal obligation to protect consumers when loans are transferred between mortgage servicers. The CFPB stated it will make servicing transfer problems a focus of its supervisory activities and will take appropriate actions, including remediation of harm to consumers. The CFPB will examine 1) how the servicer has prepared for the transfer of servicing rights or responsibilities, 2) how the new servicer handles the files it receives through a transfer, and 3) what policies servicers have in place to prevent harm to borrowers with loans that are already subject to loss mitigation procedures. The press release is available at: tinyurl.com/cfpb-service.

HUD issues final disparate impact rule. On February 8, 2013, the U.S. Department of Housing and Urban Development (HUD) issued a final rule to implement the Fair Housing Act's (FHA's) Discriminatory Effects Standard. The FHA prohibits discrimination in the sale, rental, or financing of dwellings and in other housing-related activities on the basis of race, color, religion, sex, disability, familial status, or national origin. HUD has interpreted the act to prohibit practices with an unjustified discriminatory effect even if the discrimination was unintentional. The rule clarifies that the FHA applies to practices that have a disparate impact on classes of individuals protected by the FHA. The new rule expressly permits practices to be challenged based on claims that the practice improperly creates, increases, reinforces, or perpetuates segregated housing patterns. The rule became effective March 18, 2013, and is available at: tinyurl.com/hud-disparate. On a related note, the U.S. Supreme Court recently accepted a case for review that will determine if the FHA's statutory language encompasses disparate impact claims: *Mount Holly v. Mount Holly Gardens Citizens in Action, Inc.* The court's decision, which will be issued during its 2013-14 term, could affect HUD's rule.

* 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 Z — TRUTH IN LENDING ACT (TILA)

The Third Circuit addresses how a borrower exercises the right to rescind a loan subject to TILA. *Sherzer v. Homestar Mortgage Services*, 707 F.3d 255 (3d Cir. 2013). The Third Circuit has held that “an obligor exercises his right of rescission by sending the creditor a valid written notice of rescission, and need not also file suit within the three-year period.” The federal appeals courts are divided over the timeliness of lawsuits seeking rescission that are filed more than three years after loan consummation. (Borrowers have three business days after consummation to rescind certain types of transactions, but TILA extends the rescission period to three years if the creditor fails to provide the notice of the right to cancel or the material disclosures.) In several cases, borrowers sent rescission notices to creditors within three years, but the creditors rejected the requests or did not respond, and the borrowers filed lawsuits more than three years after loan consummation. The issue is whether such lawsuits are timely because the borrower had already sent the rescission notice within the three-year period. The Third Circuit in *Sherzer* joined the Fourth Circuit in holding that a consumer’s lawsuit filed after the three-year period is timely if the consumer previously sent a rescission notice during the three-year period. See *Gilbert v. Residential Funding LLC*, 678 F.3d 271 (4th Cir. 2012). But the Ninth and Tenth Circuits have held that a borrower must also file the rescission lawsuit within the three-year period. See *Rosenfield v. HSBC Bank, USA*, 681 F.3d 1172 (10th Cir. 2012) and *McOmie-Gray v. Bank of America Home Loans*, 667 F.3d 1325 (9th Cir. 2012).

The Third Circuit in *Sherzer* noted neither TILA nor Regulation Z requires a borrower to file a lawsuit to exercise the right of rescission and instead refers to a borrower’s written notice to the creditor as the means by which a borrower exercises the right of rescission. One concern addressed in the decision is whether a borrower could strategically send a rescission notice within the three-year period and then wait several years before filing a lawsuit. The Third Circuit said courts in that circumstance would borrow the most closely analogous state or federal statute of limitations to determine if such a lawsuit were untimely.

Federal district court in Florida holds loan assignee can be vicariously liable for servicer’s post-assignment violation of TILA’s servicing requirements. *St. Breux v. U.S. Bank, N.A.*, 2013 WL 331592 (S.D. Fla. 2013). U.S. Bank, N.A., obtained the plaintiff’s mortgage loan by assignment and retained Litton Loan Servicing, L.P., to service it. The plaintiff made a request for information to Litton under Section 1641(f)(2) of TILA, which requires the servicer to identify the name, address, and telephone number of the owner or master servicer of the loan. In response, Litton identified U.S. Bank as the owner and Litton as the servicer but failed to provide all of the required information. In considering whether to dismiss the case, the court had to decide whether the assignee that owns the loan can be vicariously liable for a TILA violation committed by the servicer it retained as its agent. The court held that an owner of a loan could be held liable for the violations of its agent servicer and denied the motion to dismiss the lawsuit.

REGULATION X – REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

Tenth Circuit affirms dismissal of lawsuit because borrower failed to send a Qualified Written Request (QWR) to the address designated by the servicer. *Berneike v. CitiMortgage, Inc.*, 708 F.3d



1141 (10th Cir. 2013). The plaintiff faxed more than 80 letters to her loan servicer to dispute the billing for her mortgage loan using the subject line “Qualified Written Request (RESPA).” Some of the letters listed an Illinois address, and others listed a Nevada address, but none listed the address in Baltimore that the servicer had designated for QWRs. After the servicer responded that the billing was accurate, the plaintiff filed a lawsuit alleging the servicer violated RESPA’s QWR requirements, 12 C.F.R. §1024.21(e). This section of Regulation X requires servicers to acknowledge and respond within certain time frames to written requests from borrowers relating to the servicing of a federally related mortgage loan. The regulation permits the servicer to designate an address to which QWRs must be sent. The lower court dismissed the lawsuit. On appeal, the Tenth Circuit affirmed, noting that while the statute is silent on this issue, Regulation X permits the practice. The Tenth Circuit also did not find persuasive the plaintiff’s argument that the servicer waived the address issue because it had responded to some of the letters. The court held that if a servicer designates a mailing address for QWRs, then the servicer’s RESPA duties are only triggered if the borrower uses the designated address.

REGULATION B – EQUAL CREDIT OPPORTUNITY ACT (ECOA); FAIR HOUSING ACT (FHA)

Sixth Circuit holds that claims of disparate impact based on pricing discretion could not be certified in a class action lawsuit. *In re Countrywide Financial Corp. Mortgage Lending Practices Litigation*, 708 F.3d 704 (6th Cir. 2013). Eleven plaintiffs filed a class-action lawsuit against Countrywide Bank, N.A., under the ECOA, the FHA, and the Civil Rights Act, alleging disparities in loan pricing on the basis of race. Plaintiffs alleged that the disparities occurred because Countrywide’s loan originators were permitted to use their discretion in setting prices. Under the bank’s loan-pricing policy, the annual percentage rate for a mortgage loan had two components — an objective component based on objective factors about the borrower and the loan and a subjective component applied at the loan originator’s discretion to increase or decrease a borrower’s rate. The lower court denied class certification based on the Supreme Court’s decision in *Wal-Mart Stores, Inc. v. Dukes*, 131 S.Ct. 2541 (2011). On appeal, the Sixth Circuit affirmed, finding that the claims against Countrywide were similar to those raised in the *Dukes* case. In *Dukes*, the Supreme Court held that a lawsuit alleging employment discrimination against women because of broad discretion afforded to local store managers did not satisfy the commonality requirement for certifying a class because the plaintiffs did not establish “a common mode of exercising discretion that pervades the entire company.” The Sixth Circuit found this reasoning applicable to the Countrywide lawsuit, noting that the plaintiffs failed to submit evidence of a uniform policy or practice instructing originators to exercise their pricing discretion in a way that caused the disparate impact.

Since the *Dukes* decision was issued in June 2011, several other courts have also rejected class-action lawsuits alleging disparate impact claims under the ECOA and the FHA when lenders had pricing discretion. See *Barrett v. Option One Mort. Corp.*, 2012 WL 4076465 (D. Mass. Sept. 18, 2012); *Rodriguez v. National City Bank*, 2011 WL 4018028 (E.D. Pa. Sept. 8, 2011); and *In re Wells Fargo Residential Mortgage Lending Discrimination Litigation*, 2011 WL 3903117 (N.D. Cal. Sept. 6, 2011).

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

PERSPECTIVES ON CONSUMER PROTECTION: A CONVERSATION WITH GOVERNOR DUKE

downs of systemic controls and correction of the root cause of issues, bank management has an incentive to think of compliance as an integral part of running a successful company. This more holistic view of the examiner's role in reinforcing financial institutions' compliance culture is especially important in today's world of rapid regulatory change.

2. Can you discuss how the Federal Reserve is working to clarify supervisory expectations for, and improve communication with, community banks?

To support the work of our examiners, the Federal Reserve Board and its staff strive to develop supervisory policies and procedures that foster a culture of compliance. The expectations of a compliance program must correspond to the size and complexity of the bank. The compliance risk management program for a small bank need not be as intricate as the compliance risk management structure of a larger, more complex, institution. In the end, it is our goal to ensure that each institution under our supervision, regardless of size, is successful in managing the compliance risks present within its operations and product offerings.

Two-way communication between supervisors and community banks is critical. Banks need to understand supervisors' policies and expectations, and supervisors need to understand banks' concerns. To help us understand the perspectives of financial institutions, the Board established the Community Depository Institutions Advisory Council (CDIAC) in 2010 as a mechanism for community banks, thrift institutions, and credit unions with assets of \$10 billion or less to provide input to the Board on the economy, lending conditions, and other issues. The 12 Federal Reserve Banks also have established similar local advisory councils, and one member of each Reserve Bank's council is selected to serve on the Board's CDIAC. This approach helps to ensure a robust discussion and consideration of a variety of perspectives on current issues at the CDIAC meetings.

At one CDIAC meeting, for example, we were asked to be clearer about whether particular rules and guidance apply to community banks. We now expressly indicate

which banks will be affected when we issue new regulatory proposals, final rules, or regulatory guidance. Although this change seems relatively simple, we hope it will help banks avoid unnecessary review of supervisory guidance that does not apply to them.

In 2011, we established a supervision subcommittee of the Board on smaller regional and community banks. This subcommittee has been working to ensure that the development of supervisory guidance is informed by an understanding of the unique characteristics of community and regional banks and consideration of the potential for excessive burden and adverse effects on lending. The agendas for this subcommittee have centered on both enhanced guidance and outreach for these institutions to support their successful management of risk.

We continue to explore options for building on these initiatives. It is critical to keep the communications channels open if supervisors and banks are to work together constructively.

3. Many community banks find fair lending to be one of the most challenging aspects of their examinations. Has the Federal Reserve done anything to simplify the process?

Absolutely. When it comes to fair lending, the stakes are high for both consumers and banks, so we are committed to getting it right. Our goal is not to play "gotcha," but to make fair and accurate decisions. We think open and frank communication between examiners and banks is the key to effective fair lending supervision.

If our examiners have a fair lending concern at one of our banks, they tell the institution and are transparent about what our concerns are. We then give the institution a chance to respond. At the Board, we have a specialized Fair Lending Enforcement section that includes economists, lawyers, and analysts. The section supports the work of examiners across the Federal Reserve System and makes sure we are applying the law consistently.

We have taken several steps to clarify our expectations for fair lending compliance. For example, in 2009, along with the other financial regulators, we 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 Interagency Fair Lending Examination Procedures¹ are online and available to any bank to aid in its analysis of fair lending risks and to prepare for fair lending examinations.

In addition, we have increased our communications with banks during the examination process. To enhance the efficiency and effectiveness of our fair lending process, we often analyze electronic data we obtain from banks to determine if there are disparities in lending based on factors protected by the fair lending laws. In most cases, we do not identify concerns with our statistical reviews. As a result, this process is more efficient for both examiners and banks. But, when we do identify potential issues, some community banks express concern about their difficulty in understanding statistical analysis without hiring outside consultants. We take these concerns seriously and now take additional steps to communicate with community banks to make sure they understand the nature of our concerns and how to respond effectively.

Finally, we engage in a variety of outreach activities on fair lending, such as regular participation in conferences sponsored by both industry and advocacy groups. Our goal is to highlight fair lending risks so that institutions can take steps on their own to effectively manage fair lending compliance. We are actively evaluating ways to enhance our outreach even further. For example, in partnership with the Federal Reserve Bank of San Francisco, the Board has hosted free fair lending webinars during which the financial regulators and the federal enforcement agencies provided guidance on key fair lending issues. During our last webinar, over 5,000 financial institutions registered, the majority of which were community banks.

4. Banks have also been concerned recently that federal regulators will start using disparate impact theory

on fair lending examinations and look at new areas, such as indirect auto lending. Does the Federal Reserve intend to make changes in its supervisory program?

Actually, neither of these areas is new. Although disparate impact has received a lot of attention recently in light of a new regulation by the U.S. Department of Housing and Urban Development, almost 20 years ago, the Joint Agency Statement on Discrimination in Lending addressed disparate impact theory.² Disparate impact is also addressed in the 2009 Interagency Fair Lending Examination Procedures. So, at the Federal Reserve, we have considered disparate impact for years.

Regarding indirect auto lending, the Consumer Financial Protection Bureau (CFPB) recently issued a new bulletin on indirect auto lending that highlighted the fair lending risks in this area. This bulletin calls attention to an important risk, but indirect auto lending is not a new area for Federal Reserve examiners. The potential fair lending risks in indirect auto lending have been widely discussed for years. In fact, the Department of Justice's first settlement with a bank for indirect auto lending was based on a Federal Reserve referral.

5. In the past several years, the consumer compliance regulatory landscape has undergone significant changes. How has the Federal Reserve's role in consumer compliance regulation and supervision changed in light of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)?

The Dodd-Frank Act established a comprehensive set of financial reforms to address vulnerabilities in our regulatory system that were apparent in the financial crisis of the past several years. As a result, we have seen a rethinking and reform of financial regulation. One of the Dodd-Frank Act's most notable changes to the consumer compliance landscape was the establishment of a new agency, the CFPB. The CFPB was assigned rule-writing authority for certain designated consumer compliance laws and supervisory authority for financial institutions with over \$10 billion in assets and their affiliates.

¹ tinyurl.com/exam-procedures

² www.occ.treas.gov/news-issuances/federal-register/94fr9214.pdf

However, the Federal Reserve maintains a significant and continuing role in supervising state member banks, in particular community banks, for compliance with the consumer laws and regulations. The Federal Reserve continues to have examination and enforcement authority for all consumer laws and regulations for state member banks with assets of \$10 billion or less and for enforcing the provisions of the Community Reinvestment Act for all state member banks, regardless of size. For state member banks with assets of more than \$10 billion, the Federal Reserve retains examination and enforcement authority for consumer protection laws and regulations that were not specifically designated in the Dodd-Frank Act.

REGULATORY CHANGES ARE BEING IMPLEMENTED TO ENSURE BORROWERS HAVE MORE PROTECTIONS AND LENDERS TAKE INTO ACCOUNT THE COSTS THAT IMPRUDENT MORTGAGE LENDING CAN IMPOSE ON COMMUNITIES, THE FINANCIAL SYSTEM, AND THE ECONOMY.

While it has always been important, interagency coordination with regard to the enforcement of consumer financial laws has become even more critical since the enactment of the Dodd-Frank Act. To ensure continued high-quality supervision and to minimize unnecessary burden on institutions, the Federal Reserve and other prudential regulators entered into formal agreements addressing collaboration and sharing of information with the CFPB. Examiner teams have already begun to collaborate on supervisory events where there are consumer compliance related synergies. It is important that all of the prudential regulators and the CFPB work in a collaborative manner in order to provide for strong, yet efficient, supervision that avoids unwarranted burden on institutions while providing for robust enforcement of consumer protections.

6. Some financial institutions have expressed concern about the burden of regulatory compliance in light of the number of new requirements imposed by the Dodd-Frank Act. In particular, institutions have voiced

concerns about the burden imposed by new rules governing the mortgage market and about the impacts of those rules on the availability of mortgage credit. Can you comment on some of the challenges for institutions, and for their regulators and supervisors, in light of the new Dodd-Frank Act requirements?

Bank supervision requires a delicate balance — particularly now. The weak economy and loose lending standards of the past have put pressure on the entire banking industry, including community banks. To protect banks from new problems down the road, supervisors must insist on high standards for lending, risk management, and governance. At the same time, it is important for banks, for their communities, and for the economy that banks lend to creditworthy borrowers.

The Dodd-Frank Act includes a number of new consumer protections related to mortgage lending, many of which will become effective in January 2014. The mortgage market is reacting to a variety of economic, market, and regulatory issues that are making lenders more cautious than usual. Regulatory decisions will work individually and collectively to shape the cost and availability of mortgage credit in the future. Therefore, it is important for policymakers to think carefully about how individual decisions will work within the full constellation of mortgage regulation. Regulatory changes are being implemented to ensure borrowers have more protections and lenders take into account the costs that imprudent mortgage lending can impose on communities, the financial system, and the economy. The accompanying effect, however, may be tighter credit standards, especially for lower-credit-quality borrowers, than prevailed during most of the past decade. It will be up to policymakers, including the CFPB as rule-writer and the other federal financial regulators in their supervisory roles, to find the right balance between consumer safety and financial stability, on the one hand, and availability and cost of credit, on the other.

Therefore, it is important for policymakers to think carefully about how individual decisions will work within the full constellation of mortgage regulation. Regulatory changes are being implemented to ensure borrowers have more protections and lenders take into account the costs that imprudent mortgage lending can impose on communities, the financial system, and the economy. The accompanying effect, however, may be tighter credit standards, especially for lower-credit-quality borrowers, than prevailed during most of the past decade. It will be up to policymakers, including the CFPB as rule-writer and the other federal financial regulators in their supervisory roles, to find the right balance between consumer safety and financial stability, on the one hand, and availability and cost of credit, on the other.

We appreciate that many banks find the new rules challenging and face difficult choices about the best way to comply. We have heard specific concerns from community banks about the impact of the CFPB's qualified

mortgage (QM) rule, which was issued in January. The QM rule is part of a larger ability-to-repay rulemaking that requires lenders to make a reasonable and good faith determination that the borrower can repay the loan. If the mortgage meets the definition of QM, which includes certain limitations on interest rates, points, and fees, the lender receives some degree of protection from potential lawsuits because it is presumed that the borrower had the ability to repay the loan. We understand that the QM rule may create incentives for some lenders to originate only QM loans or to cease offering mortgages altogether.

Although I understand these decisions, community banks serve a vital need and I think it will be bad for consumers if community banks stop issuing mortgages. It would be unfortunate if the laws and regulations put in place to require other lenders to adopt the same responsible and consumer-focused practices long used by community banks have the unintended effect of forcing some community banks to leave the market.

Notwithstanding the challenges that the new regulations present, I still think the future for community banking is bright because of the vital services community banks provide. I also know that we at the Federal Reserve are doing our best to avoid adding to the regulatory burden wherever possible as we respond to the worst excesses of the financial crisis and make the U.S. financial system more resilient. I appreciate the feedback we continue to receive about the challenges that new regulations pose for community banks.

7. In light of the statutory and regulatory changes that have been implemented in response to the recent financial crisis, what consumer protection issues currently concern you most?

Financial institutions are continually developing new, innovative consumer financial products and services. Banks seek to leverage new platforms and technologies and have in recent years relied increasingly on third-party vendors, both to improve efficiencies and to provide more options for consumers. It is important to strike the appropriate balance between innovation in consumer financial products and services, which can have benefits both to banks and consumers, and ensuring that such products are fair and transparent to consumers. Institutions need to implement the appropriate controls to prevent unfair or deceptive prac-

tices as their consumer financial product offerings and business models evolve over time.

Institutions need to be particularly diligent regarding any third-party vendors they may elect to use. Banks that rely upon outside vendors to offer consumer financial products remain responsible for compliance with applicable laws and regulations. Inadequate management or oversight of third-party vendors by depository institutions presents additional consumer and compliance risks. In addition, institutions should carefully analyze the incentives created by any fee sharing or similar arrangements. Such arrangements may create particular consumer risk in connection with consumer financial products if they lead vendors to encourage inappropriate usage of such products by consumers. Institutions should develop procedures to closely monitor vendor practices and outcomes and to mitigate and manage vendor-related risks in connection with the design and marketing of new products.

8. What strategies does the Federal Reserve use to stay informed about consumer protection issues?

The Federal Reserve's ongoing consumer protection supervisory and research efforts apply a variety of strategies to address the challenges that are still ahead of us and to complement the consumer compliance reforms adopted in the Dodd-Frank Act. To illustrate, let me give you some examples of current Federal Reserve initiatives aimed to further consumer protection.

When our examiners find institutions with weak or ineffective consumer compliance programs, they take appropriate supervisory action. The Board recently assessed significant civil money penalties against two holding companies to address deceptive marketing and debt collection practices. Additionally, fair lending referrals from Federal Reserve examinations have resulted in six Department of Justice settlements over the past five years.

In support of our consumer protection mission, Federal Reserve staff is also engaged in a broad set of policy and research initiatives to promote household financial security and sustainable recovery from the financial crisis. For example, the Federal Reserve has issued guidance in the last year addressing strategies for rental of bank-owned foreclosure properties and

discouraging abandonment of the foreclosure process without notification to borrowers or local authorities. Additional guidance was issued last summer that clarified protections that should be afforded to military homeowners who receive permanent change of station orders. And, in April, we issued a supervisory letter highlighting the potential risks of deposit advance products. Beyond these concerns, Federal Reserve analysts are evaluating changes in postsecondary education financing and the possible implications of the trends in student indebtedness for individuals, households, and the broader economy. Board staff has also facilitated expert dialogues and initiated research into the financial lives and needs of older adults, a growing demographic within the U.S. population with potentially distinct patterns of use of financial services, and hosted a workshop series to explore economic development challenges and strategies for growing economies in Native American communities.

As these examples illustrate, the Federal Reserve continues to engage in a full range of consumer protection activities, which we believe are vitally important to ensure the financial well-being of members of more vulnerable populations.

9. What do you see as the role of *Consumer Compliance Outlook* in the Federal Reserve's consumer compliance supervision efforts?

Management of a successful consumer compliance program can be one of the most significant challenges for a bank's senior leadership team, especially in an environment of rapid regulatory and supervisory change. Institutions can struggle to respond to changing technical requirements encompassed in lengthy regulations. At the Federal Reserve, the ultimate goal of our consumer compliance supervision program is to foster strong compliance risk management programs in each of our supervised financial institutions. Publication of *Consumer Compliance Outlook* over the past five years has given us an additional platform to synthesize important regula-

tory changes and their impact on consumer compliance requirements, describe effective compliance risk management practices, and highlight upcoming events designed to assist compliance professionals in successfully managing their responsibilities.

Consumer Compliance Outlook articles have addressed a wide range of consumer issues, including risk-based pricing notice requirements, the right of rescission in times of foreclosure, and changes to the Real Estate Settlement Procedures Act good faith estimate and HUD-1 forms. Other articles have provided compliance management guidance in areas such as use of Home Mortgage Disclosure Act data in a financial institution's compliance program, vendor risk management, and managing consumer compliance risks in the current economic environment.

Based on positive feedback on the *Consumer Compliance Outlook* newsletter, the Federal Reserve also launched a companion webinar series, *Outlook Live*, in 2009. *Outlook Live* has further enhanced the Federal Reserve's ability to communicate in a timely and effective manner with financial institutions on consumer compliance topics. *Outlook Live* complements *Consumer Compliance Outlook* by promoting two-way communication between supervisors and financial institutions through question and answer sessions. In turn, *Consumer Compliance Outlook* has published questions and answers in follow-up to webinar topics such as fair lending, servicemember financial protection, and overdraft services.

The *Outlook* vehicles, along with our other outreach efforts, have enhanced communication regarding key supervisory and regulatory messages. Our hope is that financial institutions are able to better understand and respond to changing regulatory requirements in light of plain language explanations they receive in *Consumer Compliance Outlook*. We also hope that compliance professionals are able to use these communications to strengthen their institutions' overall consumer compliance risk management programs. ©

FAIR LENDING WEBINAR QUESTIONS AND ANSWERS

area. More specifically, the Federal Reserve typically reviews whether there is a statistically significant disparity between a bank's mortgage applications and originations in majority–minority census tracts compared with the adjusted aggregate of similar lenders. The “adjusted aggregate” is typically defined as lenders with lending activity that is between 50 and 200 percent of the bank's volume and with a rate spread incidence of less than 25 percent, but it may be adjusted further based on the bank's business model.

If available, the Federal Reserve also evaluates a bank's CRA small business data. That is, the Federal Reserve typically reviews whether there is a statistically significant disparity between the bank's small business loan originations in majority–minority census tracts compared with the adjusted aggregate. Here, the “adjusted aggregate” is typically defined as lenders with lending activity that is between 50 and 200 percent of the bank's volume, but it may be adjusted further based on the bank's business model.

Finally, the Federal Reserve may map the bank's HMDA mortgage applications and originations and CRA small business originations to assess overall lending patterns and to determine whether the bank is failing to lend in certain geographies on a prohibited basis.

PRICING

5. What factors does the Federal Reserve consider in a pricing review?

Consistent with the Procedures, the Federal Reserve considers several risk factors in a pricing review for mortgage and nonmortgage products, including:

- *Pricing Criteria:*
 - Pricing policies that treat applicants differently on a prohibited basis or are likely to have a disparate impact
 - Presence of broad discretion in loan pricing (e.g., interest rates, fees, and points), including discretion in granting exceptions to pricing policies
 - Use of risk-based pricing that is not based on objective criteria or applied consistently

- *Loan Originator Compensation:* Financial incentives for loan originators to charge higher prices
- *Documentation:* Lack of clear documentation of the reasons for pricing decisions, including exceptions
- *Complaints:* Complaints by consumers or community advocates alleging discrimination in loan pricing

Since 2009, the DOJ has settled four pricing cases based on referrals from the Federal Reserve: *United States v. Nara Bank*; *United States v. PrimeLending*; *United States v. SunTrust Mortgage, Inc.*; and *United States v. Countrywide Financial Corp.* These cases are available at: www.justice.gov/crt/about/hce/caselist.php#lending.

6. Does the Federal Reserve evaluate indirect auto lending during a pricing review?

The CFPB recently released a bulletin providing guidance for its supervised entities. The bulletin discusses the fair lending requirements of the ECOA and its implementing regulation, Regulation B, for indirect auto lenders that permit dealers to increase consumer interest rates and that compensate dealers with a share of the increased interest revenues. This guidance applies to all indirect auto lenders within the jurisdiction of the CFPB, including both depository institutions and nonbank institutions. The bulletin is available at: tinyurl.com/cfpb-indirect-auto.

The CFPB's bulletin is consistent with the Federal Reserve's longstanding practice of including indirect auto lending within its pricing reviews of nonmortgage products. For example, in 2009, the DOJ settled a pricing case with an indirect auto lender based on a referral from the Federal Reserve: *United States v. Nara Bank*, which is available at: www.justice.gov/crt/about/hce/caselist.php#lending.

7. For nonmortgage loans, what methods does the Federal Reserve use to determine the borrower's race, ethnicity, and gender?

For mortgage loans, the Federal Reserve determines the borrower's race, ethnicity, and gender based on the data collected pursuant to HMDA. For nonmort-

gage loans, the Federal Reserve 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, the Federal Reserve also uses census data to identify the majority–minority census tracts and to determine whether disparities exist between minority and nonminority areas.

UNDERWRITING

8. What factors does the Federal Reserve consider in an underwriting review?

Consistent with the Procedures, the Federal Reserve considers several risk factors in an underwriting review for mortgage and nonmortgage products, including:

- *Underwriting Criteria:*
 - Underwriting policies that treat applicants differently on a prohibited basis or are likely to have a disparate impact
 - Presence of broad discretion in loan underwriting criteria, including discretion in granting exceptions to underwriting policies
 - Use of underwriting criteria that is vague or unduly subjective or applied inconsistently
- *Loan Originator Compensation:* Financial incentives for loan originators based on underwriting factors, such as loan volume
- *Documentation:* Lack of clear documentation of the reasons for underwriting decisions, including exceptions
- *Complaints:* Complaints by consumers or community advocates alleging discrimination in loan underwriting

In 2011, the Federal Reserve referred an underwriting matter to the DOJ that involved discrimination on the basis of sex, in violation of the ECOA and the Fair Housing Act, and on the basis of familial status, in violation of the Fair Housing Act. The lender failed to consider a woman's employment status and reasonably expected income while she was on unpaid maternity leave under the Family and Medical Leave Act.

9. Can a lender require an applicant receiving Social Security Disability Insurance (SSDI) income to submit a doctor's letter to demonstrate the long-term stability of the income?

Investors generally require that underwriting be based on long-term, stable income, but lenders should ensure that they do not inadvertently impose higher standards on those receiving disability income. Recently, some lenders have required applicants receiving SSDI income to demonstrate income stability by submitting a doctor's letter describing the nature of the disability and whether it is expected to continue for at least three years. These lenders do not require applicants who are not disabled to provide proof that their income will continue for at least three years. Moreover, Fannie Mae, Freddie Mac, and the U.S. Department of Housing and Urban Development's (HUD's) Federal Housing Administration (FHA) do not require a lender to request a doctor's letter as evidence of stable income. (See Fannie Mae Single Family Selling Guide §B3-3.2-01; Freddie Mac Single Family Seller/Service Guide §37.13; HUD Mortgagee Letter 12-15 [Aug. 17, 2012].)

A lender policy requiring a doctor's letter to verify the stability of SSDI income may result in discrimination on the basis of disability in violation of the Fair Housing Act and discrimination on the basis of receipt of public assistance in violation of the ECOA. Two recent settlements by federal enforcement agencies highlight this fair lending risk:

- DOJ case: *United States v. Bank of America*, available at www.justice.gov/crt/about/hce/case_list.php#lending
- HUD case: *In re U.S. Bank National Association*, available at tinyurl.com/hud-ssi

Thus, lenders should review their policies regarding SSDI and other public assistance income to ensure that the policies comply with the Fair Housing Act and the ECOA.

10. What protections are available for lesbians, gays, bisexual, and transgender people (LGBT) seeking credit?

Recent actions by HUD have clarified and increased protections for LGBT individuals seeking mortgages. In 2010, HUD began recognizing that certain housing discrimination complaints from LGBT individuals are covered under the Fair Housing Act. HUD has stated that although the act does not specifically include sexual orientation and gender identity as prohibited bases, an LGBT person's experience with sexual orientation or gender identity discrimination may be covered by the Fair Housing Act. For example, a property

manager refusing to rent to an individual who does not conform to gender stereotypes may constitute discrimination on the basis of sex under the Fair Housing Act. Additional examples are available at: tinyurl.com/hud-lgbt-page.

In 2012, HUD issued a final rule applicable to HUD programs, including FHA loans. The rule contains several provisions, including one requiring that eligibility for FHA loans be determined without regard to the applicant's actual or perceived sexual orientation, gender identity, or marital status. The rule is available at: tinyurl.com/hud-rule-lgbt. This year, HUD entered into a settlement agreement with Bank of America regarding this rule. HUD alleged that the bank denied a loan to a couple seeking to obtain an FHA-insured mortgage because of their sexual orientation and marital status. More information about the agreement is available at: tinyurl.com/hud-LGBT-pr.

In addition to these federal actions, several states and localities provide protections for LGBT individuals. Lenders should review their policies and practices to ensure that they comply with federal, state, and local fair lending laws and regulations.

OTHER REAL ESTATE OWNED PROPERTIES

11. What are the fair lending considerations associated with banks owning other real estate owned (OREO) properties?

In light of recent economic conditions, some banking organizations may choose to make greater use of rental activities in their disposition strategies than in the past. On April 5, 2012, the Federal Reserve released a policy statement about the rental of OREO properties, which is applicable to state member banks, bank holding companies, nonbank subsidiaries of bank holding companies, savings and loan holding companies, nonthrift subsidiaries of savings and loan holding companies, and U.S. branches and agencies of foreign banking organizations (collectively, banking organizations). The policy statement reminds banking organizations that the Federal Reserve's regulations and policies permit the rental of OREO properties

to third-party tenants as part of an orderly disposition strategy within statutory and regulatory limits. The policy statement is available at: www.federalreserve.gov/newsevents/press/bcreg/20120405a.htm.

A LENDER POLICY REQUIRING A DOCTOR'S LETTER TO VERIFY THE STABILITY OF SSDI INCOME MAY RESULT IN DISCRIMINATION ON THE BASIS OF DISABILITY IN VIOLATION OF THE FAIR HOUSING ACT AND DISCRIMINATION ON THE BASIS OF RECEIPT OF PUBLIC ASSISTANCE IN VIOLATION OF THE ECOA.

On June 28, 2012, the Federal Reserve provided further guidance on OREO properties by releasing *Questions and Answers for Federal Reserve-Regulated Institutions Related to the Management of Other Real Estate Owned*, available at: tinyurl.com/fed-oreo. This guidance is intended to clarify existing policies and promote prudent practices for the management of OREO properties. With respect to fair housing compliance, the guidance noted potential risks in the rental, repairs, marketing, and sales of properties. For example, an institution should have a plan for the marketing and sale of the property in accordance with applicable federal and state laws, including the Fair Housing Act. We note that at least one consumer advocate group has filed complaints with HUD alleging that certain banks have violated the Fair Housing Act by varying their marketing and maintenance of OREO properties on a prohibited basis. Thus, banking organizations with OREO properties should review their policies and procedures to ensure that they comply with federal and state fair housing laws and regulations.

FAIR LENDING RESOURCES

12. What are some resources that banks can use to learn more about fair lending compliance?

In addition to this publication, the Federal Reserve provides several resources for financial institutions to

learn about consumer compliance, including fair lending compliance. These resources include:

- *Outlook Live* – Federal Reserve webinars on consumer compliance topics, available at: tinyurl.com/outlook-live-webinar.
- *Community Banking Connections* – a Federal Reserve publication and website dedicated to providing guidance, resources, and tools for com-

munity banks, available at: www.communitybankingconnections.org/.

Finally, the 2009 Interagency Fair Lending Examination Procedures and Appendix are available at www.ffiec.gov/PDF/fairlend.pdf and www.ffiec.gov/PDF/fairappx.pdf. Specific issues and questions should be raised with your primary regulator. ©

REGULATORY CALENDAR

Don't forget to visit the Regulatory Calendar page on our website at: tinyurl.com/calendar-CCO. This page contains a listing of recent regulatory changes with links to the change and the effective date of the change.



Consumer Compliance Outlook > Regulatory Calendar

Regulatory Calendar

Effective Date	Implementing Regulation	Regulatory Change	Outlook Article/Webinar
3/18/13	24 CFR Part 100	Final rule on disparate impact under the Fair Housing Act	
**	Reg. E	Final rule delaying 2/7/13 effective date for foreign remittance transfer rule	Q3 2012
1/18/14	Reg. B	Final rule on Dodd-Frank Act appraisal requirements under ECOA	
6/1/13 and 1/18/14***	Reg. Z	Final rule on Dodd-Frank Act requirements for loan originator compensation, mandatory arbitration, SAFE Act, and single-premium credit insurance	
1/18/14	Reg. Z	Final rule on Dodd-Frank Act requirements for high-cost mortgages and homeownership counseling	
1/18/14	Reg. Z	Final rule on Dodd-Frank Act appraisal requirements for HPMLs	
1/10/14	Reg. Z	Final rule on Dodd-Frank Act requirements for ability-to-repay and qualified mortgage standards	
1/10/14	Reg. Z	Final rule on Dodd-Frank Act requirements for servicing under RESPA	
1/10/14	Reg. X	Final rule on Dodd-Frank Act requirements for servicing under TILA	
6/1/13	Reg. Z	Final rule on Dodd-Frank Act requirements for escrows for HPMLs	
1/1/13	Reg. Z	Annual adjustment for high-cost loans	
1/1/13	Reg. M	Annual adjustment for exemption transaction threshold for leases	
1/1/13	Reg. Z	Annual adjustment for consumer credit exemption transaction threshold	
1/1/13	Reg. C	Annual adjustment to HMDA asset-size exemption threshold	
10/1/12	Reg. II	Final rule on fraud-prevention adjustment for interchange fees standards	
*	Regs. X & Z	Final rule to delay effective date for certain new mortgage disclosures	
*	Reg. E	Proposed rule to amend foreign remittance transfer final rule	
**	Reg. E	Technical correction to final rule on foreign remittance transfers	Q3 2012
**	Reg. E	Second final rule on foreign remittance transfers	Q3 2012

ADVERSE ACTION NOTICE REQUIREMENTS UNDER THE ECOA AND THE FCRA

other. For example, an employer must comply with the FCRA notice requirements when denying an employment application based on information in a consumer report⁵; however, the disclosures under Regulation B are not triggered because the application does not involve credit.

Who Must Receive Notice?

Regulation B and the FCRA differ on who must receive the adverse action notice. Regulation B defines an applicant more broadly than the FCRA, incorporating businesses as well as individuals. Table 2 shows the two requirements.

require notice to all consumers against whom adverse action is taken if the action taken was based on information in a consumer report.⁷ If the applicants' credit scores were used in taking adverse action, each individual should receive a separate adverse action notice with the credit score and related disclosures associated with his or her individual consumer report; however, an applicant should not receive credit score information about a coapplicant. Regulation B does not prohibit delivery of an adverse action notice to each applicant. If applicable, financial institutions can provide a combined notice of adverse action to all consumer applicants to comply with multiple-ap-

applicant requirements under the FCRA, provided a credit score is not required for the adverse action notice because a score was not relied upon in taking adverse action.

What Are the Notice Timing Requirements?

As shown in Table 3, Regulation B includes detailed timing requirements for adverse action notices, while the FCRA does not include such requirements. Typically, financial institutions include the disclosures required under both Regulation B and the FCRA in one adverse action notice when both notices are required. For

these combined notices, Regulation B's timing requirements apply.

For businesses with gross annual revenues of \$1 million or less, Regulation B requires notice be provided according to the same timing requirements applicable

Table 2: Who Must Receive Adverse Action Notices

Regulation B (Consumer and Business)	FCRA (Consumer)
Any applicant, including individuals applying for credit, businesses of all sizes, and any person liable or who will become liable for the debt such as a coapplicant. Guarantors are not "applicants" under Regulation B's definition of applicant ^a	Any consumer defined as an individual, including coapplicants ^b
<p>^a 12 C.F.R. §1002.2(e). See also 76 Fed. Reg. 41,590, 41,597 (July 15, 2011)</p> <p>^b See section FCRA 603(c)</p>	

The requirements are different for multiple applicants. According to Regulation B, if multiple applicants submit an application, notice need only be given to the primary applicant if the primary applicant is readily apparent.⁶ In the case of multiple applicants under the FCRA, the statute has been interpreted to

⁵ FCRA sections 615(a) and 603(k)(1)(b)(ii)

⁶ 12 C.F.R. §1002.9(f)

⁷ Section 615(a) of the FCRA requires notice to "any consumer" against whom adverse action is taken if the adverse action is based in whole or in part on information from a consumer report. The Federal Reserve Board has interpreted this to apply to co-applicants. See 76 Fed. Reg at 41,596-97.

Table 3: Timing Requirements for Adverse Action Notices

Regulation B (Consumer and Business)	FCRA (Consumer)
<p>A creditor must notify the applicant of adverse action within:[*]</p> <ul style="list-style-type: none"> • 30 days after receiving a complete credit application • 30 days after receiving an incomplete credit application • 30 days after taking action on an existing credit account • 90 days after making a counteroffer to an application for credit if the applicant does not accept the counteroffer 	<p>The FCRA does not have specific timing requirements for adverse action notices.</p>
<p>[*] 12 C.F.R. §1002.9(a)(1)</p>	

cation, (3) provide a reasonable deadline, and (4) state that the application will not be reviewed if the information is not received.¹² Regardless of which notice is provided, the notice must be provided within 30 days.¹³

What Disclosures Are Required?

Both Regulation B and the FCRA include particular content and format requirements for adverse action notices. Regulation B requires the notice be in writing except for business applicants, who may receive oral notice of adverse action.¹⁴ The

to consumers as described in Table 3.⁸ For businesses with gross annual revenues greater than \$1 million, Regulation B requires only that a creditor provide notice within a reasonable time.⁹

Common notice violations.¹⁰ Common Regulation B adverse action notification and timing errors relate to handling incomplete applications. Creditors may fail to identify an application as incomplete and, as such, fail to meet notice content and timing requirements. A creditor has two options after receiving an incomplete application: it can (1) take action on the application and notify the applicant according to Regulation B’s standard notice requirements or (2) refrain from taking action and notify the applicant that the application is incomplete.¹¹ If the creditor provides a notice of incompleteness, the notice must (1) be in writing, (2) detail the information needed to complete the appli-

FCRA, on the other hand, states that adverse action notices may be provided orally, in writing, or in electronic format.¹⁵ Although Regulation B does not specifically provide for electronic delivery, a combined adverse action notice that incorporates both Regulation B and the FCRA requirements may be provided electronically if the consent requirements of the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. §7001 et seq., are complied with.¹⁶

Appendix C of Regulation B contains model adverse action notices that include the disclosures required under both Regulation B and the FCRA. Although not mandatory, proper use of the model notice forms satisfies the adverse action disclosure requirements of the FCRA and the ECOA. Table 4 includes current adverse action disclosure requirements for Regulation B and the FCRA.

⁸ 12 C.F.R. §1002.9(a)(3)(i)

⁹ 12 C.F.R. §1002.9(a)(3)(ii)(A)

¹⁰ *Outlook* published an article on common compliance violations in the First Quarter 2011 issue that included a discussion of issues with ECOA adverse action notices. See “View from the Field: Commonly Cited Compliance Violations in 2011,” available at: tinyurl.com/commonviolations.

¹¹ 12 C.F.R. §1002.9(c)(1)

¹² 12 C.F.R. §1002.9(c)(2)

¹³ 12 C.F.R. §1002.9(a)(1)

¹⁴ 12 C.F.R. §1002.9(a)(3)(i)(A) and (a)(3)(ii)(A)

¹⁵ FCRA section 615(a)(1)

¹⁶ *Outlook* reviewed the consent requirements for the E-Sign Act in the Fourth Quarter 2009 issue: “Moving from Paper to Electronics: Consumer Compliance Under the E-Sign Act,” available at: tinyurl.com/esign-cco.

Table 4: Content Requirements for Adverse Action Notices

<p>Regulation B (Consumer and Business)</p>	<p>FCRA (Consumer)</p>
<p>Notice provided shall include the following disclosures:^a</p> <ul style="list-style-type: none"> • The creditor’s name and address • An ECOA antidiscrimination notice substantially similar to the one in 12 C.F.R. §1002.9(b)(1) • The name and address of the creditor’s primary regulator • A statement of action taken by the creditor • Either a statement of the specific reasons for the action taken or a disclosure of the applicant’s right to a statement of specific reasons and the name, address, and telephone number of the person or office from which this information can be obtained 	<p>Section 615(a) notice (adverse action based on information in a consumer report) must include the following disclosures:^b</p> <ul style="list-style-type: none"> • Notice that adverse action was taken based on information obtained from a consumer reporting agency • The consumer’s right to: <ul style="list-style-type: none"> ◦ Obtain a free copy of his or her consumer report from the consumer reporting agency providing the information if requested within 60 days ◦ To dispute the accuracy or completeness of any information in a consumer report furnished by the consumer reporting agency • The name, address, and telephone number of the consumer reporting agency that furnished the report to the person • A statement that the consumer reporting agency did not make the credit decision and is unable to provide to the consumer the specific reasons why the adverse action was taken • Credit score disclosures if the credit score was a factor in taking adverse action <p>Section 615(b)(1) notice (consumer credit denied or a charge for credit increased based on information obtained from third parties other than consumer reporting agencies) must include the following disclosures:</p> <ul style="list-style-type: none"> • The consumer’s right to request the information that was relied on in taking adverse action within 60 days of receipt of the adverse action notice; the information must be provided to the consumer within a reasonable period of time <p>Section 615(b)(2) notice (taking adverse action based on information obtained from an affiliate) must include the following disclosures:</p> <ul style="list-style-type: none"> • Notice that adverse action was taken based on information from an affiliate and the consumer’s right to obtain the information by sending a written request within 60 days after receipt of the adverse action notice; the information must be provided within 30 days after receiving the request

^a 12 C.F.R. §1002.9(a)(2)(i) and (ii)

^b FCRA section 615(a)(2)-(a)(4)

Similar to the timing requirements, the contents of the disclosures under Regulation B may vary based on the type of applicant or account holder. For businesses with gross annual revenues of \$1 million or less, the notice must include the same information described in Table 4, except the disclosure of the applicant’s right to receive the statement of reasons can be given at application.¹⁷ For businesses with gross annual revenues greater than \$1 million, a creditor is only required to provide a statement of reasons for adverse action and the ECOA antidiscrimination statement if

the applicant makes a written request for the information within 60 days of notification.¹⁸

Common content violations. Regulation B adverse action errors involving content typically relate to the statement of specific reasons for the action taken. The regulation requires the statement to be specific and indicate the principal reason(s) for taking adverse action.¹⁹ Creditors should disclose up to four principal reasons; disclosure of more than four reasons is unlikely to be helpful to the applicant.²⁰ Violations often

¹⁷ 12 C.F.R. §1002.9(a)(3)(i)

¹⁸ 12 C.F.R. §1002.9(a)(3)(ii)

¹⁹ See 12 C.F.R. §1002.9(b)(2) and commentary to that section

²⁰ Comment 9(b)(2)-1 of the Official Staff Commentary for Regulation B

involve inaccurate, ambiguous, or confusing statements of the principal reasons.

When are additional FCRA credit score disclosures required?

Section 1100F of the Dodd-Frank Act amended the FCRA to include additional disclosure requirements when adverse action is taken because of the consumer's credit score. Specifically, the FCRA requires a person to make the following disclosures in writing or electronically as part of the adverse action notice in addition to those identified in Table 4:

- The consumer's numerical credit score used by the person in taking adverse action²¹
- The range of possible credit scores;
- All the key factors that adversely affected the credit score²²;
- The date on which the credit score was created; and
- The name of the person or entity providing the credit score or the information upon which score was created.

But if the credit score did not play a role in the decision to take adverse action, these disclosures are not required.²³ One question that frequently arises is whether credit score disclosures are required for adverse action on a credit application where the creditor already provided a credit score disclosure because the creditor uses the credit score exception method of complying with the FCRA risk-based pricing (RBP) rules. Under this compliance option, the creditor provides RBP notices with credit scores to *all* applicants. A creditor taking adverse action in this circumstance must *still* include the credit score disclosure in the

adverse action notice because the credit score exception notice is provided at a different time in the application process and serves a different purpose than the adverse action notice.²⁴

Credit score disclosures cannot be combined with any other disclosures required under the FCRA, although they can be combined with the adverse action notice disclosures required by Regulation B. Finally, the credit score disclosures cannot be provided on a separate form; they must be included on the adverse action form.²⁵

Key factors. A person relying on a credit score in taking adverse action is required by section 615(a) of the FCRA to disclose the key factors adversely affecting the consumer's credit score. Because credit scores are typically purchased from a consumer reporting agency, that agency is in the best position to identify the factors that adversely affected the score. The final rule therefore permits disclosure of the reasons identified by the agency to satisfy the key factors requirement.²⁶

Providing applicants with a list of key factors affecting their credit score does not relieve the creditor of its duty to also disclose, under Regulation B, the reasons for taking adverse action. In some instances, the key factors affecting a credit score will be the same as the reasons for taking adverse action under Regulation B. But in other cases, they may be unrelated. For example, a creditor may deny a loan application because of factors unrelated to a credit score, such as an applicant's income, employment, or residence.²⁷

²¹ Under section 609(f)(2)(A) of the FCRA and section 1100F of the Dodd-Frank Act, "credit score" means "a numerical value or a categorization derived from a statistical tool or modeling system used by a person who makes or arranges a loan to predict likelihood of certain credit behaviors, including default." In some cases, a person may use a proprietary scoring system that results in a proprietary score that also meets the definition of "credit score." 76 Fed. Reg. at 41,594.

²² FCRA section 609(f)(9). The number of key factors listed should not exceed four; however, if the number of inquiries was listed as a key factor but not one of the top four, this should be listed as a fifth key factor. See *also* 76 Fed. Reg. at 41,593.

²³ 76 Fed. Reg. at 41,592

²⁴ 76 Fed. Reg. at 41,596

²⁵ Section 615(a). For more information, see the two prior *Outlook* articles on risk-based pricing notices: "An Overview of Risk-Based Pricing Implementing Regulations" (Fourth Quarter 2010), available at: bit.ly/rb-article, and "An Overview of Credit Score Disclosure Requirements for Risk-Based Pricing Notices" (Third Quarter 2011), available at: tinyurl.com/rbp-cs.

²⁶ 76 Fed. Reg. at 41,592

²⁷ 76 Fed. Reg. at 41,592

In addition, a person cannot provide an applicant with a general reference to the key factors that affected a credit score as a reason for taking adverse action under Regulation B.

Multiple credit scores.²⁸ In certain cases, a person may receive multiple credit scores from consumer reporting agencies. If the person only uses one credit score in making the decision, that particular score and related information for that specific credit score must be disclosed. If the person uses multiple credit scores in making the credit decision, only one of the scores is required to be disclosed; however, the FCRA does not prohibit creditors from disclosing multiple credit scores to the consumer.

Common violations related to credit score disclosures. Violations involving the FCRA's requirement to include credit score information in adverse action notices typically involve failing to recognize when the requirement applies. The disclosure requirements are triggered when a credit score is used by a person in taking adverse action.²⁹ Some violations have occurred when persons interpreted the term "use" too narrowly to include only situations when adverse action is solely or primarily based on the credit score. Similarly, other violations have in-

involved persons incorrectly providing additional credit score disclosures only in cases when a minimum credit score was established. To avoid these violations, a person must provide the additional credit score disclosures whenever a credit score is used in the decision to take adverse action.

CONCLUSION

Compliance with the requirements of both Regulation B and the FCRA involving adverse action decisions is important to provide applicants and account holders timely and relevant information. To ensure compliance with the rules, financial institutions should implement appropriate policies and procedures. In addition, financial institutions should ensure that updates for automated disclosure systems are received, tested, and correctly implemented. A strong training program, both for current regulations and any recent changes, will help ensure compliance. Controls that a financial institution may consider include a secondary review of all adverse action notices and a consistent process, even in excess of regulatory requirements, such as delivering a combined adverse action notice to all consumer applicants. Specific issues and questions should be raised with your primary regulator. ©

²⁸ 76 Fed. Reg. at 41,597

²⁹ FCRA section 615(a)(2)(A). See also 76 Fed. Reg. 41,590, 41,592 (July 15, 2011) ("Section 1100F of the Dodd-Frank Act requires disclosure if a credit score was used in taking adverse action. A creditor that obtains a credit score and takes adverse action is required to disclose that score, unless the credit score played no role in the adverse action determination. If the credit score was a factor in the adverse action decision, even if it was not a significant factor, the creditor will have used the credit score for purposes of section 1100F of the Dodd-Frank Act.")

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CALENDAR OF EVENTS

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|-----------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| July 11, 2013 | Indianapolis Interagency CRA Training
Hilton Garden Inn Indianapolis – Airport
Indianapolis, IN |
| July 17, 2013 | Fair Lending Risks from a Functional Area Perspective
FDIC Regulatory Teleconference |
| July 17, 2013 | Oregon CRA Roundtable (Invitation Only)
Portland Marriott Downtown Waterfront
Portland, OR
FDIC, OCC, and Federal Reserve Bank of San Francisco |
| September 19–20, 2013 | 2013 Policy Summit on Housing, Human Capital, and Inequality
Federal Reserve Banks of Cleveland and Philadelphia
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