

CONSUMER COMPLIANCE OUTLOOK[®]

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



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RISK-FOCUSED CONSUMER COMPLIANCE SUPERVISION PROGRAM FOR COMMUNITY BANKS

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On November 18, 2013, the Federal Reserve Board released its new consumer compliance risk-focused examination program for community banks to promote strong compliance risk management practices and consumer protection within state member banks with assets of \$10 billion or less and their subsidiaries.¹ The program took effect January 1, 2014. While the Federal Reserve has traditionally applied a risk-focused approach to consumer compliance examinations, the new program more explicitly links examination intensity and activities to an institution's risk profile, including its consumer compliance culture and how effectively it identifies and manages compliance risk. The program balances the nature and breadth of supervision with the level of risk to consumers and institutions, to provide for the effective and efficient use of resources. The program also provides guidance and flexibility so examiners can customize the supervisory approach to each institution's unique compliance risks.

This article provides an overview of the program framework and its components, and discusses what community banking institutions can expect in their examinations and how to incorporate the program into their own compliance management systems. See CA Letter 13-19, including the appendices, for complete details. Additionally, the March 6, 2014, Outlook Live webinar on the same topic is archived and available for reference.² This issue of *Outlook* also contains a question and answer article on page 2 based on questions received during the webinar.

RISK-FOCUSED SUPERVISION FRAMEWORK

The program provides a framework for examiners to evaluate an institution's consumer compliance management program in the context of the risk associated with its business activities. The program is guided by the following supervisory principles:

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¹ See CA Letter 13-19 at <http://www.federalreserve.gov/bankinforeg/caletters/caltr1319.htm>

² See March 6, 2014, Outlook Live webinar at www.tinyurl.com/webinar-RFS

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RISK-FOCUSED SUPERVISION WEBINAR QUESTIONS AND ANSWERS

On March 6, 2014, the Federal Reserve System conducted an Outlook Live webinar titled "Community Bank Risk-Focused Consumer Compliance Supervision Program." Participants submitted a significant number of questions before and during the session. Because of time constraints, only a limited number of these questions were answered during the webcast. This article addresses some of the other questions we received.¹

In the current climate, there are many demands on our staff's time and it is a challenge to stay on top of regulatory issues. Can you cut to the bottom line and tell me how my examinations will change?

You will likely see a shift in examination time, with more time spent during the risk assessment and examination planning process before examiners enter your bank and less time spent on low-risk issues. This may result in shorter on-site examinations.

Specifically, examiners will develop an institution profile and a comprehensive risk assessment for the products, services, and activities that are material to the bank and evaluate the controls in place to manage those risks before an on-site examination is conducted. The enhanced risk assessment will permit examiners to more precisely scope and plan the on-site portion of the examination and customize examination work to the residual risk of the bank's products or services. This means that examiners will focus on areas where residual risk is elevated and not on areas where inherent risk is well controlled and residual risk is limited or low.

Examiners will also contact you between examinations. The program includes ongoing supervision, which will typically be a touch point at the midpoint of the examination cycle. Ongoing supervision will help examiners understand changes in the types and complexity of product offerings and the consumer compliance management program. It also ensures that our supervisory information is up to date. Ongoing supervision allows for more engagement in the supervisory process and timely communication from both the institution and the examiners.

What products will examiners consider to be high risk?

Product risk is evaluated based on the inherent risk factors identified in the risk-focused supervision (RFS) program and the extent to which the associated risk controls effectively mitigate that risk. The scope and examination work plan are driven by residual risk, not inherent risk alone. Therefore, even if a product is subject to more complex regulations and is considered higher risk, the bank's

¹ The webinar has been archived and is available at www.tinyurl.com/webinar-RFS.

control of that risk will be considered. Of course, there could be some products — especially new ones — with high inherent risk where it may be appropriate for the examiners to test the efficacy of the controls before concluding that the inherent risk is effectively mitigated.

Because of the new risk-based examination approach, is it possible that transaction testing will not be performed for every regulation?

Yes, that is correct. Under the new program, examiners are not expected to transaction test every regulation. One of the core principles of the RFS program is that examination resources should be allocated based on risk. If, after balancing the level of inherent risk and the effectiveness of risk controls, the residual risk is limited or low, no transaction testing will likely be required. Even when residual risk may be higher for a particular product, it may be the case that risks are associated with only certain aspects of the product. In such cases, examiners may test compliance with regulations related to those higher residual risk elements, while they may choose not to test rules related to other aspects of the product where evidence indicates compliance risk is adequately controlled. For example, examiners may choose to test compliance with advertising rules but not other disclosure rules if the examiners' concerns are solely related to advertising.

How is materiality defined or measured?

Examiners will evaluate product materiality as part of the risk assessment process. Materiality considers the relative importance of a product within the context of the bank's business model and strategic plan. It is determined primarily by volume, as measured in numbers, dollars, or both. A product with greater volume compared to other products will be considered more material than a product with less volume. For example, examiners may determine that a product is not material because it has a very low level of activity. On the other hand, examiners may determine that a product with significant volume is material, even if the product has lower volume than other products. Furthermore, examiners will take into account potential growth in a product. Accordingly, a new product with only nominal activity at the time of the examination may be considered material due to anticipated product growth, particularly if the product is closely aligned with the bank's business model and/or strategic plan.

We note that materiality does not only consider originations. For some bank activities, such as loan servicing, the appropriate gauge for materiality would be the number of loans serviced and/or the dollar size of the serviced portfolio. Regardless of a product's materiality, the bank is expected to comply with all applicable consumer protection laws and regulations. Evaluating management's willingness and capacity to comply will be part of the assessment of the effectiveness of the consumer compliance management program.

I've seen assessments of a bank's inherent/residual risk where risk ratings are assigned to each regulation rather than to specific products. Is this method outdated?

The RFS program evaluates the overall risks of products, not regulations. Nonetheless, the laws and regulations that apply to a product — and the associated complexity of those regulations — remain an important factor when establishing the inherent risk of a product. Legal and regulatory risks, however, are not the only factors considered. Bank decisions concerning the features of a product and how the product is delivered are also important indicators of an institution's risk appetite. A product that has many types of fees imposed under different conditions may have more risk than a similar product with a much less complex fee structure, even though both are subject to the same regulations. And a product delivered only through a bank's branch locations will likely involve less risk than the same product delivered by third parties or via the Internet.

How will the institution's overall control of compliance risk (oversight, policies and procedures, etc.) impact the rating of residual risk associated with a specific product risk?

An institution's consumer compliance management program will have an important impact on the examiner's assessment of residual risk. The residual risk of a product is determined by balancing the inherent risk of an activity with the overall strength of the risk controls for that activity. Accordingly, an institution with strong controls, policies, and procedures will likely have a more favorable residual risk rating than an institution that offers the identical product without adequate compliance management.

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NEWS FROM WASHINGTON: REGULATORY UPDATES*

Consumer Financial Protection Bureau (CFPB) Issues Research Report on Payday Lending. On March 25, 2014, the CFPB issued a research report on payday lending. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the CFPB has supervisory authority over payday lenders.

The report's key findings include the following:

- More than 80 percent of payday loans are rolled over within 14 days.
- Three out of five payday loans are made to borrowers whose fee expenses exceed the amount borrowed.
- One out of five new payday loans cost the borrower more than the amount borrowed.
- Four out of five payday borrowers either default or renew a payday loan over the course of a year.
- Only 15 percent of borrowers repay all of their payday debts when due without reborrowing within 14 days.
- Of new loans, 15 percent of them are followed by a loan sequence at least 10 loans long — roughly half of all loans are made in the course of a sequence at least 10 loans long.
- Few borrowers amortize their loans. Instead, for more than 80 percent of loans analyzed, the last loan in a sequence of loans is the same size as, or larger than, the first loan in the sequence.
- Monthly borrowers are more likely to stay in debt for 11 months or longer.
- Most borrowing involves multiple renewals following an initial loan, rather than multiple distinct borrowing episodes separated by more than 14 days.

CFPB Reports on Consumer Complaints About Information Furnished to Consumer Reporting Agencies (CRAs). On February 27, 2014, the CFPB reported that it handled roughly 31,000 complaints between October 22, 2012, and February 1, 2014, from consumers concerning information creditors furnished to CRAs. The top three concerns include incorrect information on a credit report, complaints about the investigation conducted by the CRA, and difficulty obtaining a credit report or score. The report reiterates that if a consumer files a dispute directly with a furnisher and is not satisfied with the results, the consumer may submit a complaint to the CFPB, which sends it to the furnisher for a response. If the consumer remains dissatisfied with the furnisher's response to the CFPB, he or she may dispute the response with the CFPB within 30

days. The CFPB previously issued a bulletin on September 4, 2013, to furnishers of consumer credit information highlighting their obligations under the Fair Credit Reporting Act. The bulletin stated that the CFPB will continue to review furnisher compliance with these requirements during examinations and investigations.

CFPB Issues Bulletin to Highlight Furnishers' Obligation to Investigate Disputed Information in a Consumer Report. On February 27, 2014, the CFPB published a supervisory bulletin warning companies that furnish information to CRAs not to avoid investigating consumer disputes. In some cases, the CFPB has observed that when a consumer disputes furnished information, the furnisher will not conduct an investigation and will instruct the CRA instead to delete the item it furnished. The CFPB cautions that a furnisher should not assume that simply deleting an item will generally constitute a reasonable investigation. The CFPB reported that this practice can harm consumers because once a dispute is filed, if the furnisher determines the information it furnished was inaccurate, it must notify all companies that received the information, including other CRAs. But if the furnisher simply deletes the disputed information without notifying those companies, the companies will not be aware it is inaccurate. An investigation could also uncover broader problems in the furnisher's system or process, such as software flaws, that impact the accuracy of the information furnishers provide to CRAs.

The Federal Reserve Board (Board) Will Soon Begin Publishing a Semiannual Report with Aggregate Data and Other Information Regarding Banking Applications. On February 24, 2014, the Board announced it will be publishing a semiannual report with aggregate data and other information concerning banking applications. The report is expected to be released in the second half of 2014 and will include statistics on the length of time taken to process applications and notices; the number of approvals, denials, and withdrawals; and the primary reasons for withdrawals. The Board evaluates applications for proposed acquisitions or requests to establish branches in light of statutory factors, financial condition, performance under the Community Reinvestment Act, and managerial experience. If issues are identified that result in a recommendation that the Board deny an application, staff informs the filer of the particular issues.

The new semiannual report is designed to increase transparency to the public of the application process by providing more detailed information about the basis for withdrawn applica-



tions. In cases where the application is approved or denied, an announcement is made to the public. The Board also released guidance describing common issues it has identified that led to the recent withdrawal of applications, including less-than-satisfactory supervisory rating(s) for safety and soundness, consumer compliance, or the Community Reinvestment Act; inadequate compliance with the Bank Secrecy Act; and concerns regarding the financial condition or management of the proposed organization.

CFPB Is Considering Changes to Regulation C — Home Mortgage Disclosure Act (HMDA). On February 7, 2014, the CFPB announced it is in the early stages of the rule-making process to amend Regulation C to implement HMDA amendments in the Dodd-Frank Act and to make other changes to help the public and financial regulators better understand borrowers' access to mortgage credit. As required by the Small Business Regulatory Enforcement Fairness Act, the CFPB is first seeking early feedback from small lenders. The changes the CFPB is considering include:

- adding the new HMDA data fields required by the Dodd-Frank Act, including (among others) the length of the loan term, total points and fees, the length of any teaser or introductory interest rates, and the applicant or borrower's age and credit score
- exercising its discretionary authority under the Dodd-Frank Act to add other new HMDA fields the CFPB believes will be beneficial, including mandatory reporting of denial reasons; debt-to-income ratios; qualified mortgage status; combined loan-to-value ratios; automatic underwriting systems results; total origination charges; total discount points; risk-adjusted, prediscouted interest rate; base interest rate; manufactured housing data; and the loan's affordable housing program status

The CFPB is also seeking feedback on ways to streamline reporting, to standardize the threshold for HMDA reporting, to improve data entry and collection, and to provide better access to HMDA data.

The CFPB Issues Reports on Loan Servicing. On January 30, 2014, the CFPB issued its "Supervisory Highlights" report for Winter 2013. In particular, the report highlights several unfair and deceptive practices examiners identified in the mortgage servicing market in 2013, prior to the effective date of the new Dodd-Frank Act servicing rules, including:

- *unfair and deceptive practices relating to servicing transfers* — The rights to manage a loan are frequently bought and sold among servicers. Two servicers failed to honor existing permanent or trial loan modifications after a servicing transfer, as a result of which borrowers were charged or told to pay the wrong amount.
- *unfairly requiring waivers of consumer rights* — Two servicers required borrowers to waive existing claims as a condition for obtaining a forbearance or loan modification agreement without regard to individual circumstances.
- *poor payment processing* — Examiners found a servicer misrepresented how biweekly payment plans work. As a result, consumers did not obtain the savings they expected. Another servicer told borrowers they would receive refunds from their escrow accounts, when in fact they would not.
- *failing to furnish correct information to CRAs* — Mortgage servicers generally provide data to CRAs. CFPB examiners found cases where servicers were misreporting short sales as foreclosures, which have a more significant negative impact on a consumer's credit report and score.

CFPB Proposes Rule to Oversee Larger Nonbank International Money Transfer Providers. On January 23, 2014, the CFPB issued a proposed rule to include certain nonbank international money transfer providers in its nonbank supervision program. The Dodd-Frank Act authorizes the CFPB to supervise nonbanks in the specific markets of residential mortgage origination, payday lending, and private education lending. It also authorizes the supervision of "larger participants" in other markets for financial services. The Dodd-Frank Act directs the CFPB to conduct a rulemaking to define "larger participants." Under the proposed rule, a nonbank international money transfer provider that offers more than 1 million international money transfers annually would be a "larger participant" subject to the CFPB's supervisory authority. The CFPB estimates the proposed rule would bring new oversight to about 25 of the largest providers in the market. The CFPB also has the authority to exercise supervisory authority over nonbank providers of financial goods and services that do not meet the definition of "larger participant" if the CFPB has reasonable cause to believe they pose a risk to consumers based on consumer complaints or other sources. See 12 U.S.C. §5514(a)(1)(C).

* Links to the announcements are available in the online version of *Outlook* at www.consumercomplianceoutlook.org.

ON THE DOCKET: RECENT FEDERAL COURT OPINIONS*

REGULATION Z — TRUTH IN LENDING ACT (TILA)

The Seventh Circuit holds that a retailer did not violate TILA by replacing its customers' store-only credit cards with general purpose Visa credit cards. *Acosta v. Target Corp.*, 745 F.3d 853 (7th Cir. 2014). The retailer Target began a program in 2000 to replace all of its customers' store-only credit cards with general-purpose Visa credit cards. The store cards were deactivated after the Visa cards were mailed. The plaintiffs' class-action lawsuit alleged that this program violated Section 132 of the TILA, 15 U.S.C. §1642, which prohibits the mailing of unsolicited credit cards, and Section 127(c), 15 U.S.C. §1637(c), which requires credit card mailings to provide disclosures in a tabular format.

The Seventh Circuit affirmed the district court's dismissal of the case. While Section 132 generally only permits a credit card issuer to send a card in response to an application, it allows an issuer to substitute or renew an existing card. The court determined that replacing a store card with a general purpose card, provided the store card was deactivated when the general purpose card was issued, constituted a substitution under the common usage of the term and comment 12(a)(2)-2.iii of the Official Staff Commentary to Regulation Z and was therefore permissible. Similarly, Section 127(c) requires a card issuer to make certain disclosures in tabular format for new credit accounts, but the format is not required when changes are made to an existing account. The court determined that the version of Regulation Z in effect during this program did not clearly define "new account." In the absence of specific regulatory guidance, the court found Target's reliance on the dictionary definition of "account" was reasonable to support its position that the issuance of the Visa card did not constitute a new account. The court also noted that a 2009 amendment to the Official Staff Commentary for Regulation Z clarified the definition of "new account," but it was not in effect when Target conducted the program and therefore did not apply.

REGULATION II — ELECTRONIC FUND TRANSFER ACT (EFTA)

The D.C. Circuit reverses decision vacating the Federal Reserve Board's (Board) interchange fee regulation. *NACS v. Board of Governors of the Federal Reserve System*, 746 F.3d 474 (D.C. Cir. 2014). The Durbin Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 U.S.C. §1693o-2, added a new EFTA Section 920 and directed the Board, among other things, to issue a regulation for debit cards that ensures the following: "The amount of any interchange transaction fee ... shall be reasonable and proportional to the cost incurred by the card issuer with respect to the transaction." In July 2011, the Board issued a final rule establishing a cap for interchange fees of 21 cents per transaction plus an ad valorem component of five basis points based on the transaction's value for fraud losses. A merchant trade group filed a lawsuit in the federal district court in Washington, D.C., alleging that the Board's regulation violated the plain language of the statute by allowing debit card issuers to recover certain costs not authorized by the statute and did not properly implement the statute's limitation on the card issuers' ability to restrict the use of payment card networks. The district court granted summary judgment to the merchants and vacated the Board's rule. But on appeal, the D.C. Circuit Court of Appeals reversed the district court's decision and held that the Board's rules generally rested on a reasonable construction of the statute, except for a provision allowing issuers to recover transaction monitoring costs. The court found that the Board had not sufficiently explained its rationale for allowing recovery of transaction monitoring costs and remanded the case to the district court to allow the Board to explain its rationale on this point. The banking industry had closely monitored the appeal because of concern that if the district court's decision were upheld, the Board would have to revise its rule and significantly lower the amount of interchange fees debit card issuers can charge merchants.

REGULATION H — NATIONAL FLOOD INSURANCE ACT (NFIA)

Both the First and Eleventh Circuits affirm dismissal of class-action lawsuits concerning flood insurance requirements for FHA-insured mortgages. *Kolbe v. BAC Home Loans Servicing, LP*, 738 F.3d 432 (1st Cir. 2013)(en banc) and *Feaz v. Wells Fargo Bank, N.A.*, 745 F.3d 1098 (11th Cir. 2014). Several class-action lawsuits have been filed against Federal Housing Administration (FHA) lenders that required borrowers to obtain more flood insurance than the minimum amount required under the NFIA. Several federal district courts have issued opinions in these cases with conflicting results. Compare *Cannon v. Wells Fargo Bank, N.A.*, 917 F.Supp.2d 1025, 1044 (N.D.Cal. 2013) (dismissing class-action lawsuit because the NFIA and the U.S. Department of Housing and Urban Development's (HUD) regulation establish the minimum amount of required flood insurance, not the maximum) and *LeCroix v. U.S. Bank, N.A.*, 2012 WL 2357602, at *4 (D. Minn. June 20, 2012)(similar) with *Casey v. Citibank, N.A.*, 915 F.Supp.2d 255, 262 (N.D.N.Y. 2013) (denying motion to dismiss lawsuit because FHA mortgage agreement could plausibly be construed to establish the maximum amount of flood insurance), *Arnett v. Bank of America, N.A.*, 874 F. Supp.2d 1021, 1032 (D. Or. 2012)(similar), *Skansgaard v. Bank of America, N.A.*, 896 F. Supp.2d 944, 948 (W.D. Wash. 2011)(similar), and *Wulf v. Bank of America, N.A.*, 798 F.Supp.2d 586, 588-89 (E.D. Pa. 2011)(similar).



Now two federal appeals courts have addressed this issue. In *Kolbe*, the plaintiff sued its loan servicer, BAC Home Loans Servicing (BAC), after it required the plaintiff to obtain an additional \$46,000 in flood insurance over the minimum requirements under the NFIA (the lesser of \$250,000 or the loan balance) for an FHA-insured loan. The lawsuit alleged that BAC violated a standard covenant in the FHA's mortgage agreement that required the borrower to obtain flood insurance to the extent required by HUD. A HUD regulation for FHA loans, 24 C.F.R. §203.16a, specifies that flood insurance must be maintained in an amount at least equal to the lesser of the loan balance or the maximum available under the NFIA. BAC filed a motion to dismiss the lawsuit based on additional language in the covenant, stating that the lender can specify the amount of hazard insurance required. The district court dismissed the lawsuit, finding that HUD's implementing regulation refers to the *minimum* amount of flood insurance that must be obtained, not the maximum, and that the other language in the covenant clarified that the lender could require more than the minimum to protect its collateral. On appeal, the First Circuit affirmed the dismissal.

The Eleventh Circuit faced the same issue in *Feaz*. The plaintiff's FHA lender required her to obtain \$63,000 in flood insurance for her loan of \$61,928. The loan was later sold to Wells Fargo, which notified the borrower that she must obtain flood insurance in the amount of \$250,000 or the replacement value of the property, whichever is less, or Wells Fargo would force-place it. When the borrower did not comply, Wells Fargo force-placed flood insurance. (The opinion does not indicate the amount of insurance that was forced-placed.) The borrower responded with a class-action lawsuit. The district court granted Wells Fargo's motion to dismiss. On appeal, the Eleventh Circuit affirmed. First, the court noted that when a federal regulatory scheme requires standard contractual language, the language must be interpreted in light of the goals of the federal policy being implemented. The court found that the borrower's interpretation limiting flood insurance to the maximum amount required under the NFIA was inconsistent with the FHA's policy goals. The court also noted that HUD's regulation states that flood insurance must be purchased in an amount "at least equal to" the NFIA's requirements, indicating that HUD wanted to establish the minimum amount of required flood insurance — not the maximum. The court therefore affirmed the dismissal of the case. The *Kolbe* and *Feaz* decisions are the first two federal appellate courts to address this issue.

REGULATION V — FAIR CREDIT REPORTING ACT (FCRA)

The Third Circuit clarifies furnisher's duties with respect to certain federally backed education loans. *Seamans v. Temple University*, 744 F.3d 853 (3d Cir. 2014). In an issue of first impression, the Third Circuit reversed a district court's dismissal of a lawsuit alleging that Temple University violated the FCRA in the way it furnished information to the consumer reporting agencies (CRAs) about a delinquent student loan and the way it investigated the student's dispute of the furnished information. The plaintiff defaulted on a Federal Perkins Loan from Temple in 1992 but repaid it in 2011. When the loan was repaid, Temple for the first time reported some of the account history to the CRAs but did not include the date that the borrower was first delinquent or that the loan was turned over for collections. Under Section 623(a)(5)(A) of the FCRA, 15 U.S.C. §§1681s-2(a)(5)(A), furnishers must report this information to allow the CRAs to determine when to remove stale negative information from a consumer's report (which generally must be removed after seven years, except for a bankruptcy filing, for which the period is 10 years).¹ See 15 U.S.C. §1681c(a). However, the Higher Education Act (HEA) instructs CRAs to disregard the aging-off provisions of the FCRA when reporting data on certain federally backed education loans, including Perkins Loans. See 20 U.S.C. §1087cc(c)(3). Despite the student filing several disputes, Temple did not revise its reporting to include the missing information nor did it indicate that its failure to report the information was under dispute. Accordingly, the negative history remained on the student's credit report.

The lawsuit alleged that Temple violated the FCRA by not reporting the date the loan was delinquent and turned over to collections (thus preventing the CRAs from knowing when to remove the information under §605(a)) and by not reporting the student's continued dispute of the furnished information after investigation. Temple argued that the HEA exempted it from compliance with the FCRA because the credit instrument at issue was an HEA-qualified Perkins Loan. The Third Circuit found that the exemption only applies to CRAs and that furnishers must report the collection history and date of delinquency of student loans. The court also examined whether Temple could be liable for conducting an inadequate postdispute investigation, which could give rise to damages. The court found that a furnisher must conduct a reasonable investigation and remanded the case for further proceedings on several issues of material fact, including whether Temple's conduct was reasonable. Finally, the court held that a private right of action arises when a furnisher receives notice from a consumer of a potentially meritorious dispute and subsequently fails to report to the CRAs that the claim is disputed. The court remanded the issue of whether Temple violated this duty to the district court.

* Links to the court opinions are available in the online version of *Outlook* at www.consumercomplianceoutlook.org.

¹ *Outlook* reviewed these requirements in detail in the second quarter 2012 issue, Kenneth Benton and Casey McHugh, "Furnishers' Compliance Obligations for Consumer Credit Information Under the FCRA and ECOA."

CONSUMER COMPLIANCE RISK MANAGEMENT FOR SOCIAL MEDIA

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Do you remember not too long ago when chat rooms, one of the earliest forms of social media, were the primary means to communicate online? But in recent years, social media has evolved significantly into many different forms, and its use has grown exponentially worldwide. For example, Facebook, the world's largest social networking site, reported that it had 1.19 billion users worldwide as of September 30, 2013.¹ This figure accounts for roughly 17 percent of the world's population.² Through social media, financial institutions are reaching consumers in ways previously unimaginable.

Although financial institutions have identified a number of ways to use social media strategically, its use is not without risks. It is important that the board of directors and senior management identify and manage these risks appropriately, including compliance risks. If you use social media at your financial institution, consider the following: Do you know the level of your risk exposure? Do you know if and how your employees are using social media to solicit business or otherwise interact with customers? Are you aware of potential compliance or other risks inherent in this form of communication?

Because of financial institutions' increased use of social media and the attendant risks, the Federal Financial Institutions Examination Council (FFIEC) issued supervisory guidance, titled "Social Media: Consumer Compliance Risk Management Guidance" (Guidance), in December 2013, to highlight potential compliance risks and sound risk management practices.³ This article focuses on this Guidance, which the FFIEC issued to help financial institutions understand how existing requirements and supervisory expectations apply to the use of social media.

WHAT IS SOCIAL MEDIA?

First, we need to define social media under the Guidance. Although social media is commonly thought of in

the context of "friending," "tweeting," or "pinning," the Guidance defines it more broadly to include "a form of interactive online communication in which users can generate and share content through text, images, audio, and/or video." Therefore, while common social networking sites such as Facebook, Twitter, and Pinterest are included in the definition of social media, the Guidance also applies to other forms of media communication such as blogging, customer review forums, and virtual worlds (e.g., Second Life). E-mail and text messages, standing alone, do not fall under this definition of social media; however, they may be otherwise subject to a number of consumer protection laws and regulations discussed in the Guidance.

HOW ARE FINANCIAL INSTITUTIONS USING SOCIAL MEDIA?

Social media may provide varying benefits depending upon a financial institution's strategic execution. Perhaps the most common social media strategy for financial institutions is marketing products and services. However, as the use of social media expands, institutions are implementing it in a variety of ways. While certainly not an exhaustive list, social media has been used by financial institutions to advertise loan incentives and loan pricing, generate applications for new accounts, track and respond to customer complaints and feedback, facilitate outreach, inform consumers of community events, and assist in debt collection efforts. Although social media can provide great rewards for financial institutions with a simple "click of a button," its use also presents unique risks and risk management challenges for financial institutions.

COMPLIANCE RISK MANAGEMENT

The board of directors and senior management should identify, measure, monitor, and control risks associated with an institution's use of social media for banking activities. To manage potential risks, finan-

¹ See <http://newsroom.fb.com/Key-Facts> (accessed December 12, 2013)

² See www.census.gov/popclock/ (accessed December 12, 2013)

³ 78 Fed. Reg. 76297 (Dec. 17, 2013)

cial institutions should ensure risk management programs provide oversight and controls commensurate with the risks presented by the types of social media in which the institution is engaged. The Guidance discusses the following strategies for the board of directors and senior management to consider for managing social media compliance risk.

1. **Create a governance structure.** The board of directors and senior management should clearly define the appropriate use of social media and how its use contributes to the institution's strategic goals. Further, this structure must have clearly defined roles and responsibilities for establishing controls and ongoing monitoring of risk related to social media activities.
2. **Develop policies and procedures.** Policies should establish the expectation to comply with all consumer protection laws and regulations that are applicable to the institution's use of social media. Procedures should also be developed for monitoring risk that may arise from receiving and responding to online postings from consumers.
3. **Manage third-party relationships.** Risk management processes should be developed to identify, select, and manage third-party relationships.
4. **Provide employee training.** Employees should be provided with training regarding management's guidelines for official, work-related use of social media.
5. **Institute audit and compliance monitoring.** These functions should ensure compliance with internal policies and procedures on proprietary social media sites.
6. **Listen to your customers.** Oversight processes should be established to monitor online postings to proprietary social media sites, whether administered directly or by a contracted third party. Content posted by consumers may assist in identifying potential areas of compliance or reputational risk. Management teams can use this information to monitor trends and red flags and conduct compli-

ance-monitoring reviews, as necessary.

7. **Report to the top.** The board of directors and senior management should be given information that will provide a comprehensive understanding of the risks present in the institution's social media activities and whether the social media program is achieving its stated objectives.

CONSUMER COMPLIANCE RISKS

What are the consumer compliance risks inherent in the use of social media? This seems to be the \$64,000 question, particularly as the capabilities of social media continue to expand. The Guidance addresses a number of areas in which social media may have consumer compliance implications. Each financial institution should ensure that it periodically evaluates and controls its use of social media to ensure compliance with all applicable federal, state, and local laws and regulations, as appropriate. It is important to note that the laws and regulations discussed in the Guidance and summarized below are illustrative and not exhaustive.

Marketing of Deposit and Lending Products

Financial institutions commonly use social media to market and advertise various deposit and lending products or services. When social media is used for these purposes, financial institutions should consider the following consumer compliance laws and regulations:

- **Regulation Z** — Regulation Z broadly defines *advertisement* as "a commercial message in any medium that promotes, directly or indirectly, a credit transaction."⁴ Therefore, financial institutions promoting a credit transaction via social media should be mindful to comply with all advertising requirements as well as to provide clear and proper disclosure of actually available terms and should recognize that different advertising requirements apply to open-end⁵ and closed-end⁶ credit.
- **Regulation DD** — Regulation DD provides a similar definition of advertisement for deposit products.⁷ Financial institutions promoting deposit

⁴ 12 C.F.R. §1026.2(a)(2)

⁵ Regulation Z, 12 C.F.R. §1026.16

⁶ Regulation Z, 12 C.F.R. §1026.24

⁷ Regulation DD, 12 C.F.R. §1030.2(b)

products via social media should ensure that advertisements are not misleading or inaccurate and should be aware of certain terms that trigger additional disclosure.⁸

- **Deposit or Share Insurance** — Advertisements of insured products delivered by social media must include required deposit insurance or share insurance disclosures. As such, the Federal Deposit Insurance Corporation (FDIC) Member logo⁹ or the official advertising statement of the National Credit Union Administration (NCUA)¹⁰ should be included in an institution's social media messages, as applicable.
- **Equal Housing Lender** — For financial institutions engaged in residential mortgage lending, each social media site administered by such institutions should disclose the Equal Housing Lender logo and legend.¹¹
- **Nondeposit Investment Products** — For financial institutions that promote nondeposit investment products, there should be clear disclosure that the products are not insured by the FDIC or NCUA, are not deposits or other obligations of the institution and are not guaranteed by the institution, and are subject to investment risks, including possible loss of the principal invested.

Fair Lending

The use of social media may also raise fair lending concerns. Therefore, financial institutions should ensure that their use of social media complies with fair lending laws and regulations. For example, Regulation B, which implements the Equal Credit Opportunity Act, prohibits creditors from making "any oral or written statement, in advertising or otherwise, to applicants

or prospective applicants that would discourage on a prohibited basis a reasonable person from making or pursuing an application."¹²

The Fair Housing Act (FHA) also makes it unlawful to advertise or make any statement that indicates a limitation or preference based on race, color, national origin, religion, sex, familial status, or handicap.¹³ Similarly, the Federal Reserve Board prohibits member banks from publishing advertisements for dwelling-secured loans, or loans to purchase, construct, improve, repair, or maintain a dwelling, that "contain any words, symbols, models, or other forms of communication that express, imply, or suggest a discriminatory preference or policy of exclusion in violation of the provisions of the Fair Housing Act or the Equal Credit Opportunity Act."¹⁴ Therefore, social media postings by financial institutions, regardless of purpose (e.g., marketing, consumer feedback), should not directly identify or infer a preference for, or exclusion of, a particular group of applicants on a prohibited basis.

Unfair or Deceptive Acts or Practices (UDAP)

When using social media for any purpose, it is important to consider Section 5 of the Federal Trade Commission (FTC) Act, which prohibits unfair or deceptive acts or practices,¹⁵ and Sections 1031 and 1036 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.¹⁶ Financial institutions should keep in mind that UDAP not only applies to all products and services generally but also applies to related activities over the entire life cycle of a product. Therefore, UDAP risk may increase when financial institutions use social media for marketing and advertising purposes. Bank advertisements should be designed to avoid unfairness

⁸ Regulation DD, 12 C.F.R. §1030.8

⁹ 12 C.F.R. part 328

¹⁰ 12 C.F.R. part 740

¹¹ See *Board Order on Fair Housing Advertising and Poster Requirements*, 54 Fed. Reg. 11567 (March 21, 1989); 12 C.F.R. §128.5, §338.4, §390.146

¹² Regulation B, 12 C.F.R. §1002.4(b)

¹³ 42 U.S.C. 3601 et seq, 24 C.F.R. part 100 (HUD), 12 C.F.R part 128 (OCC), 12 C.F.R. part 390 subpart G (FDIC), 12 C.F.R. §701.31 (NCUA)

¹⁴ Board Order, 54 Fed. Reg. 11567 (March 21, 1989); 12 C.F.R. §338.3 (FDIC fair housing regulation for nonmember banks)

¹⁵ 15 U.S.C. §45

¹⁶ 12 U.S.C. §§5531, 5536

or deception. To accomplish this, as stated in CA Letter 07-08,¹⁷ advertisements should be clear, balanced, and timely and present not only the benefits of products or services but also any potential risks.

Customer Feedback and Complaints

Many financial institutions use social media to connect directly with their customers by accepting customer complaints or feedback and providing real-time responses. Financial institutions are not expected to monitor and respond to all Internet communications, but they should be aware that certain consumer laws and regulations may apply to communications that occur through social media.

Whether communicated through blogs, consumer review sites, an institution's social networking page, or a written consumer complaint, negative feedback can be a red flag for financial institutions in identifying broader and more serious issues, including unfair or deceptive acts or practices, or fair lending violations. Because consumers can connect immediately with a large consumer network through these online communities, negative feedback provided online can also represent reputational risk for an institution. Based on the institution's risk assessment, a financial institution may want to consider monitoring social media forums to identify and, when appropriate, address negative feedback.

CUSTOMER PRIVACY

Some consumers may not appreciate the risks in providing account information in a public social media forum. Financial institutions should maintain procedures to address any public posting of confidential or sensitive information on the institution's social media page or site.

The Guidance also provides the following considerations for privacy-related activities:

- **Gramm-Leach-Bliley Act (GLBA) Privacy Rules** — Whenever a financial institution collects, or otherwise has access to, information from or about

consumers, it should evaluate whether these rules apply. The Guidance reminds financial institutions using social media to clearly disclose privacy policies as required under GLBA.

- **CAN-SPAM Act and Telephone Consumer Protection Act** — These acts and their implementing rules establish requirements for sending unsolicited commercial messages ("spam") and unsolicited communications by telephone or short message service text messages, respectively. Financial institutions delivering unsolicited communications through social media should evaluate whether their activities trigger the application of these laws.
- **Children's Online Privacy Protection Act (COPPA)** — COPPA and the FTC's implementing regulation imposes certain requirements on operators of websites or online services directed to children under 13 years of age and on operators of other websites or online services that have actual knowledge that they are collecting information from a child under 13 years of age. The Guidance recognizes that certain social media platforms require users to attest that they are at least 13 years of age and indicates that financial institutions may consider relying on such policies. In addition, the Guidance states that a financial institution maintaining its own social media site should be careful to restrict access to those users 13 years of age and older.
- **Fair Credit Reporting Act (FCRA)** — The Guidance clarifies that FCRA restrictions and requirements apply for making solicitations using eligibility information, responding to direct disputes, and collecting medical information in connection with loan eligibility when social media is used for these activities.

COMMUNITY REINVESTMENT ACT (CRA)

Depository institutions subject to the CRA must maintain all written comments received from the public for the current year and each of the prior two calendar years that specifically relate to the institution's performance in helping to meet community credit needs.¹⁸ These comments must be retained in the bank's CRA

¹⁷ See Federal Reserve Board, CA Letter 07-08, "Consumer Compliance Examination Procedures for the Unfair or Deceptive Acts or Practices Provisions of Section 5 of the Federal Trade Commission Act," November 6, 2007, available at www.federalreserve.gov/boarddocs/caletters/

¹⁸ 12 C.F.R. §228.43(a)(1)

public file. The Guidance clarifies that comments made about the institution through Internet sites that are not administered by the institution are not necessarily deemed to be received by the institution and, thus, would not need to be retained. However, if comments are received through websites or social media pages run by or on behalf of the institution, such comments should be retained in the public file.

ADDITIONAL RISKS

The Guidance identifies a number of legal, reputational, and operational risk areas in addition to the consumer compliance risks previously noted. Notable risk areas include the Bank Secrecy Act, payment systems, fraud and brand identity, and third-party concerns. Financial institutions should identify the laws

and regulations that apply to their social media activities and manage all risks appropriately.

CONCLUSION

Many financial institutions have concluded that social media can play a pivotal role in achieving business goals. However, the rewards from the use of social media do not come without risks, especially as social media capabilities continue to evolve at a rapid pace. As new advances are made in technology, it is essential that the board of directors and senior management teams stay on top of emerging risks because the proper risk management infrastructure for compliance can only be built upon risks that are adequately identified and assessed. Specific issues and questions should be raised with your primary regulator. ©

CONTINUED FROM PAGE 1...

RISK-FOCUSED CONSUMER COMPLIANCE SUPERVISION PROGRAM FOR COMMUNITY BANKS

- *risk-focused* — evaluates a financial institution's compliance culture and processes for identifying, measuring, monitoring, and controlling risks and practices regarding the treatment of consumers, the potential for consumer harm, and compliance with consumer protection laws and regulations
- *proactive and scalable* — balances the nature and breadth of supervision with the level of risk to consumers and financial institutions
- *efficient* — incorporates procedures and processes to ensure good stewardship of examiner resources
- *clear* — provides guidance, policies, procedures, and examination findings clearly
- *collaborative* — engages other disciplines and supervisory agencies, as appropriate, to ensure a coordinated supervisory approach

The graphic on page 13 displays the supervisory framework and process.

UNDERSTANDING THE INSTITUTION

Critical to the risk-focused supervision process is an understanding of an institution's operations and the

environment in which it operates. This requires the development of an institutional profile that provides a concise portrait of an institution's structure, including its consumer compliance management program, and activities that give rise to potential consumer harm and consumer compliance risk. A key outcome from developing the profile is establishing the institution's tolerance for consumer compliance risk. This risk tolerance is reflected in the choices the institution makes regarding the scope and complexity of its business activities. Institutions that engage in riskier activities, such as higher-cost products or products targeted to vulnerable or less financially sophisticated consumers, demonstrate a higher tolerance for risk and must have stronger controls in place to manage those risks effectively.

Examiners will contact bank management in advance of the examination to ensure that they have up-to-date information regarding the institution and the market(s) in which it operates. Special attention will be paid to changes since the last examination, including changes in management personnel, organizational structure, or the institution's strategic direction, includ-

ing any new products, markets, or delivery channels the institution has introduced or entered or is considering introducing or entering.

THE RISK ASSESSMENT PROCESS

The risk assessment process is robust and thus enables examiners to draw reasonable and reliable conclusions about risk. This process requires an evaluation of material products and services, the level of associated inherent risk, the adequacy of risk controls, and the overall residual risk of those products.

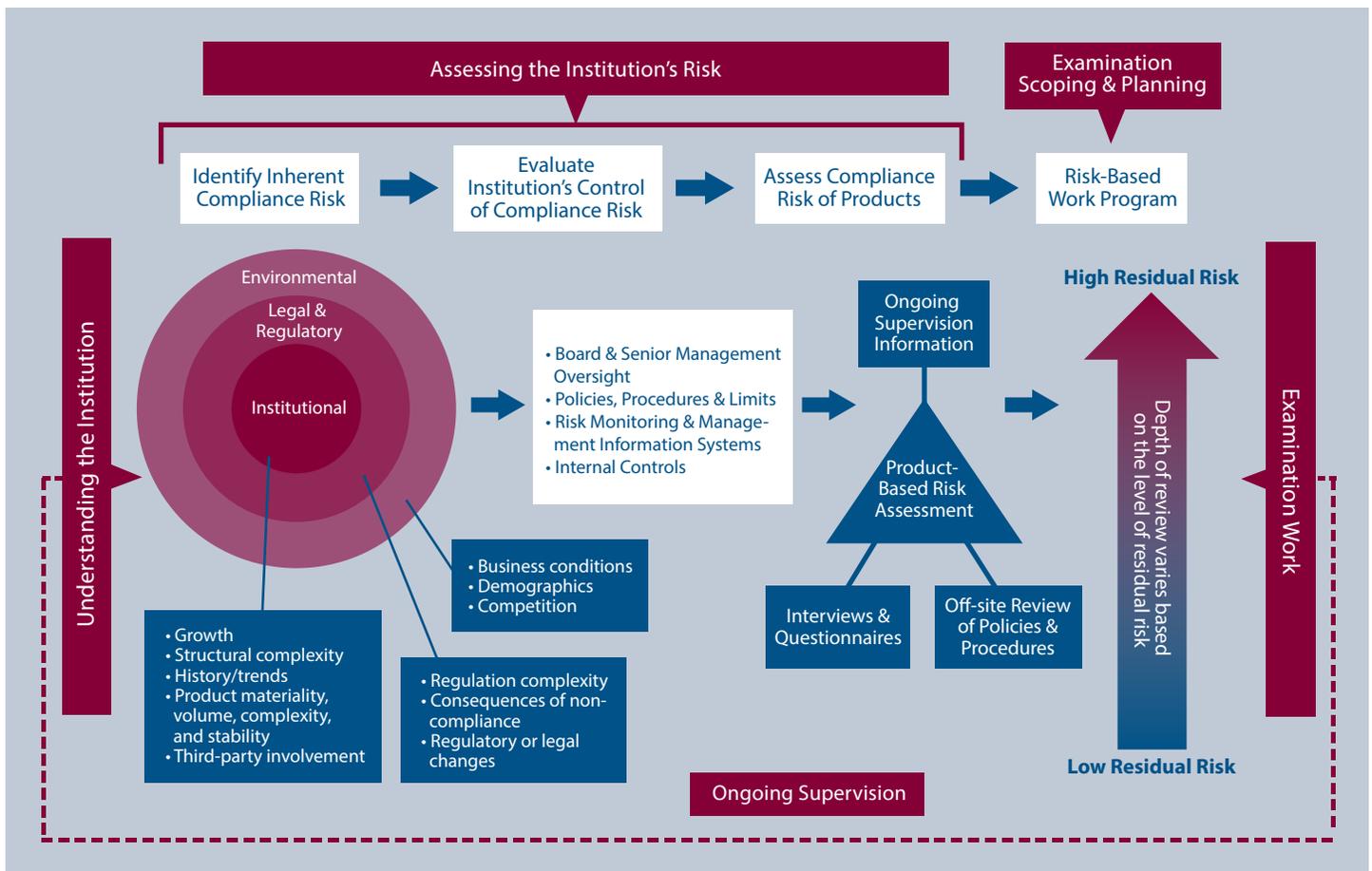
When assessing a compliance program’s overall effectiveness, emphasis will be placed on identifying an institution’s material products and evaluating the level of inherent risk along with the effectiveness of controls. A determination about product materiality will consider the relative importance of a product compared with others offered by the institution. Nonetheless, a product with low volume relative to other products could still be material if its actual volume is substantial. In addition, a product with low volume could be considered material if it is new or has a particularly risky feature. Examination intensity and the level of examination ac-

tivity should be commensurate with the residual consumer compliance risks associated with the institution’s material products. Of course, an institution is expected to maintain sufficient oversight to ensure compliance with all applicable consumer compliance laws and regulations, even in the case of material products that do not pose significant potential risk as well as in the case of products that are not found to be material.

Because of the potential for significant consumer harm and the impact on legal, financial, and reputational risks, fair lending and unfair and deceptive practices will always be addressed in the risk assessment process. Fair lending evaluation intensity for a particular product will generally be commensurate with the level of residual risk identified in the risk assessment process. However, in circumstances where inherent risk is high, examiners generally will test the risk controls before concluding that the risk is effectively mitigated.

Inherent Risk

Inherent risk is the risk of consumer harm or noncompliance with consumer protection laws and regulations posed by an institution’s products and services absent



controls or other mitigating factors. It considers the likelihood and impact of noncompliance with consumer laws and regulations prior to considering any mitigating effects of risk management processes. Risk management and controls are evaluated in the context of their likely effectiveness in achieving compliance with laws and regulations. Residual risk is determined by balancing the overall level of inherent risk of an activity (either a product or service) with the overall strength of risk controls for that activity.

The new community bank supervision program groups inherent risk factors into three categories: institutional, legal and regulatory, and environmental. Each category includes a variety of subfactors that are considered when assessing the inherent risk of an institution's products and services. Guidance for evaluating these factors, found in Appendix 2 of the program document, may be leveraged by an institution to enhance understanding of its own inherent risk.

Institutional risk factors originate from strategic and business decisions as well as products offered. The following factors tend to elevate the level of inherent consumer compliance risk:

- rate of growth
- complexity of products
- decentralized operations
- products targeted to vulnerable or less financially sophisticated consumers
- failure to serve certain consumer or geographic segments of the market
- introduction of substantively new products
- multiple delivery channels
- third-party involvement

Growth, in particular, can elevate inherent risk. Any substantive increase in asset size, change in business focus, or expanded market or geographic presence may increase compliance risk given the need to manage risk across a larger organization.

The risk related to legal and regulatory requirements is determined by the complexity of the requirements applicable to specific products and services, the level and likelihood of potential consumer harm or other penalties, and the extent to which requirements may have changed. The impact on inherent risk depends on the nature and type of the regulatory change and the

significance of the change relative to an institution's product offerings, processes, or procedures.

Environmental risk factors originate from business conditions, the demographic composition of assessment areas or broader market areas, and competition in the institution's markets. The robustness of an institution's strategic planning and change management practices must be commensurate with the degree or rapidity of change associated with competitive demands.

Risk Management Controls

The core elements of a sound consumer compliance management program include the traditional four pillars: board and senior management oversight; policies, procedures, and limits; risk monitoring and management information systems; and internal controls. The adequacy of an institution's compliance management program and its expected level of sophistication and formality are evaluated in the context of the inherent risk associated with the institution's complexity, business strategy, activities, and organizational structure. As such, a smaller institution will be evaluated differently than a larger, more complex institution. Expectations for risk controls may vary among products or business lines. The effectiveness of an institution's product management — its ability to identify, measure, monitor, and manage the compliance risk inherent to a particular product — is assessed using the four pillars and directly impacts the examination scope and the associated work plan. Details on the types of factors examiners may consider in the context of the pillars can be found in Appendix 3 of the program document. This guidance may be used by an institution to evaluate and inform its own compliance management program.

In addition to the core elements of a sound consumer compliance management program, the new program places emphasis on vendor or service provider management. An institution can appropriately decide to outsource operational aspects of a product or service but cannot outsource the responsibility for complying with laws and regulations. Accordingly, examiners will assess whether the institution utilizes sound vendor management practices, including effective due diligence, clear compliance expectations and standards, evaluation of compliance risks associated with vendor products or services, and monitoring vendors' adherence to contractual requirements.

Regardless of the size of the institution, management must maintain an effective process to manage change. Elements of an effective change management function include:

- repeatable processes
- engagement of appropriate management and staff
- consideration of the effects of the change over the entire life cycle of an affected product or service
- appropriate approval and monitoring processes
- up-to-date policies and procedures and staff training
- post-implementation review

An institution's change management process will be considered as part of the overall evaluation of risk management.

Residual Risk

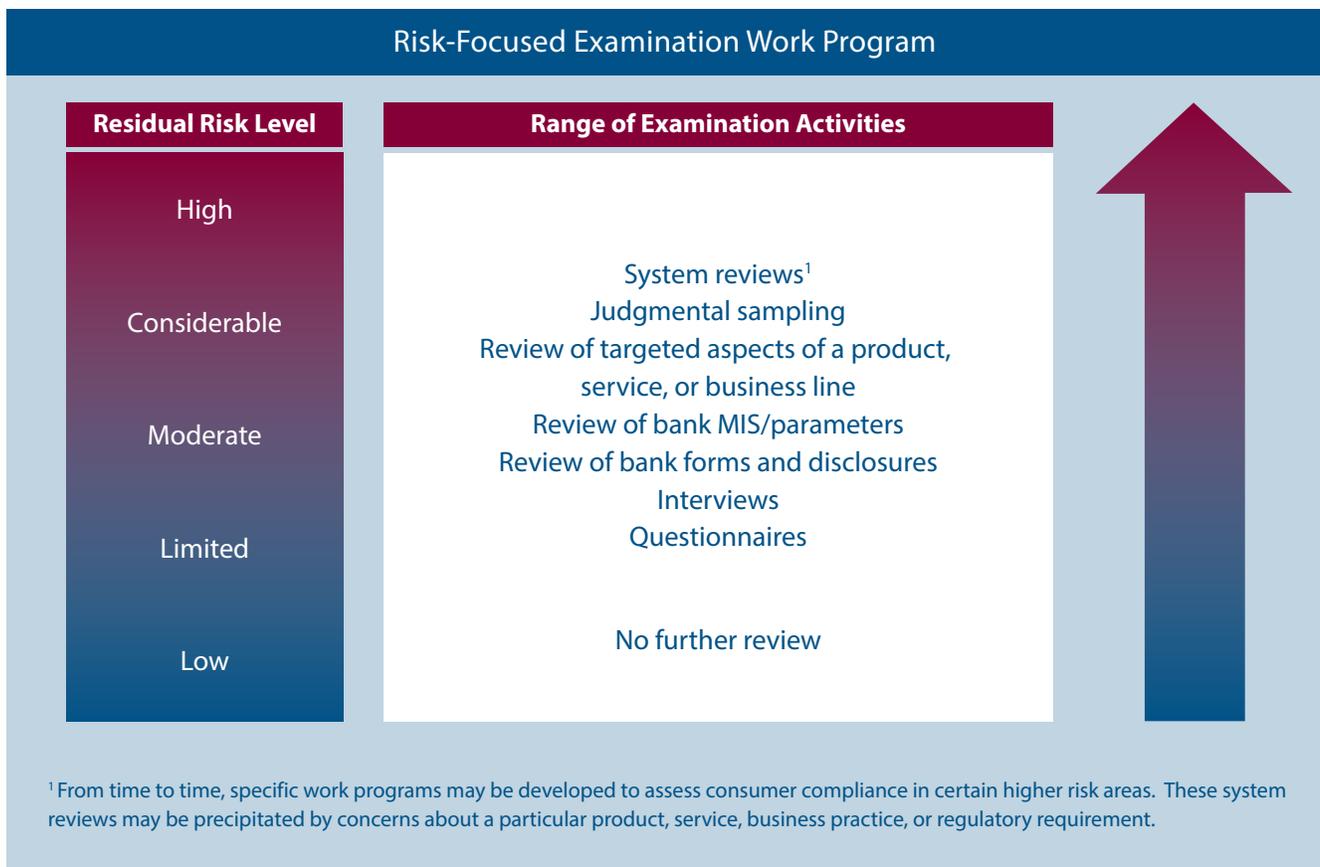
Residual product risk considers the level of inherent risk of a product and the mitigating effect of risk controls. The residual risk for each material product is then aggregated to determine the institution's overall residual risk. The risk assessment is relied upon to develop the scope of examination activities and to focus resources on areas of elevated residual risk and not on

those areas where inherent risk is well controlled and residual risk is limited or low.

EXAMINATION PLAN AND SCOPING

The risk assessment facilitates the customization of the examination scope and work plan based on the residual risks of material products and services. The assessment of an institution's ability to manage its material products and services drives the overall assessment of the compliance program as well as the depth of review associated with a range of activities available for examining each product and service. The scoping process provides an opportunity to customize examination activities so that they are consistent with the size, complexity, and risk profile of the financial institution. In this way, it is expected that a broad range of examination activities will be considered for products, services, and business lines targeted for additional review.

If there is a reasonable basis for relying on an institution's controls and a product or service has low or limited residual risk, no additional work beyond that performed during the risk assessment process may be warranted. High residual risk, however, will likely ne-



cessitate additional activities, including transaction testing. The graphic on page 15 provides an example of the range of activities available based on the residual risk of products.

ONGOING SUPERVISION

The new program incorporates an ongoing supervision element that will typically take place around the midpoint between supervisory events and will include a standard questionnaire, which can be found in Appendix 1 of the program document. This process will focus on the identification of key changes that may impact the institution's consumer compliance risk profile, including changes to the institution's products and elements of its consumer compliance management program. The up-to-date view of consumer compliance risks that this provides will facilitate more efficient risk assessment and examination planning processes.

The ongoing supervision process also promotes enhanced communication between institution manage-

ment and examination staff regarding supervisory expectations, changes in regulatory requirements, and emerging risks. Finally, ongoing supervision helps to inform examiners for the next supervisory event.

CONCLUSION

With the new community bank risk-focused supervision program, institutions will likely notice improvements in the examination process. More communication will take place up front, which will likely result in an improved understanding of the institution and an examination that is much more targeted to material products and services with elevated residual risk. Ongoing supervision will improve communication throughout the supervisory cycle and allow for more efficient interaction between examiners and institutions. Overall, the flexibility of the new approach and increased pre-examination work is expected to shorten on-site examination time and reduce the regulatory burden on many community banks. Specific issues and questions should be raised with your local Federal Reserve Bank. ©

CONTINUED FROM PAGE 3...

RISK-FOCUSED SUPERVISION WEBINAR QUESTIONS AND ANSWERS

Will an examiner's risk assessment be shared with the financial institution?

While the risk assessment document is considered part of the examination work product and is not shared, examination staff will convey to bank management the products and services that the examiner considers to have higher residual risk and the basis for these conclusions. Additionally, the work program's scope will reflect the products and services that examiners consider to contain higher risk; the associated examination activities will be consistent with a product's elevated residual risk. Finally, the report of examination will include an evaluation of the consumer compliance management program. Thus, the bank should have a full understanding of the examiner's view of the risks associated with the bank's products or services.

My business model and strategy are plain vanilla and stable. I already spend a lot of time on consumer com-

pliance and keeping up with all the regulatory changes. Will this program increase my regulatory burden?

We expect that examiners will spend less time on low-risk compliance issues at community banks, increasing the efficiency of our supervision and reducing regulatory burden on many community banks. Our consumer compliance examiners now will base examination intensity more explicitly on the individual community bank's risk profile, weighed against the effectiveness of the bank's compliance controls. Examiners will perform more comprehensive risk assessments before they are on site at the bank. Thus, if a bank maintains a strong consumer compliance management program that effectively identifies and manages the consumer compliance risks of its products, services, and activities, on-site examinations will likely be shorter.

Specific issues and questions should be raised with your local Federal Reserve Bank. ©

Congress Passes the Homeowner Flood Insurance Affordability Act of 2014

On March 21, 2014, President Barack Obama signed into law H.R. 3370, the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA).¹ The law repeals and modifies certain provisions of the Biggert-Waters Flood Insurance Reform Act of 2012 (BWA) and makes other changes to the National Flood Insurance Program (NFIP).

Congress enacted the BWA, in part, to address the NFIP's growing deficit. The BWA directed the Federal Emergency Management Agency (FEMA) to phase out subsidies and grandfathered rates and implement actuarially sound pricing for flood insurance to reflect the risk of floods.

After updating flood insurance rate maps (FIRMs) in some parts of the country, FEMA began publishing preliminary notices with premiums in some cases that had increased substantially as a result of the remapping activities. Many policyholders affected by these changes expressed concerns that the new premiums were unaffordable.

The banking industry closely followed these developments because of concern that higher flood insurance premiums might contribute to increased mortgage delinquencies or defaults. Real estate sales in areas with significant rate increases were also being adversely affected because some potential homebuyers could not afford the new premiums. Congress passed the HFIAA to address those concerns and implement other changes to the NFIP.

Among the HFIAA's key provisions are:

- Section 3 repeals the provision in the BWA that eliminated subsidies on properties purchased after July 6, 2012, on properties with no insurance on that date, and on properties where the policy lapsed as of that date, unless the lapse occurred because the property was no longer required to retain coverage. As a result, FEMA must refund any excess premiums paid by policyholders after July 6, 2012. Subsidies will continue to be phased out for pre-FIRM nonprimary residences, business properties, properties experiencing severe repetitive loss, or properties that were substantially damaged or improved. This section also implements the ability of a purchaser to assume the seller's policy at existing premium rates.
- Section 4 repeals the provision of the BWA that phased out grandfathered rates. Grandfathering allows certain property owners to be protected from a future rate increase that results from a property being remapped into a higher-risk zone. Grandfathering will also apply when a property eligible for grandfathered rates is sold to a new owner.
- Section 5 limits rate increases to 18 percent per year for individual policies, except for nonprimary residences, business properties, properties experiencing severe repetitive or cumulative loss, or properties that are substantially damaged or improved. For the exceptions, rate increases are limited to 25 percent per year until full-risk rates are achieved. For any individual class of properties, rate increases are limited to 15 percent per year.
- Section 6 clarifies rates for properties newly mapped into areas with special flood hazards. For the first year, the property is charged the preferred risk premium, after which full-risk rates are phased in, but increases cannot exceed the limits in Section 5.
- Section 8 applies an annual assessment of \$25 per policy on all NFIP primary homes and \$250 on second homes and commercial properties. The assessment, which is designed to help to fund the costs of the HFIAA, expires after risk-based premiums are fully implemented.
- Section 13 clarifies that flood insurance is not required for a detached nonresidential structure that is part of a residential property (such as a greenhouse). However, lenders have the discretion to require insurance on these structures. Section 13 also amends the Real Estate Settlement Procedures Act (RESPA) to require a new disclosure in the settlement cost booklet that lenders must provide to applicants for loans subject to the RESPA: "Although you may not be required to maintain flood insurance on all structures, you may still wish to do so, and your mortgage lender may still require you to do so to protect the collateral securing the mortgage. If you choose to not maintain flood insurance on a structure and it floods, you are responsible for all flood losses relating to that structure."

¹ See www.gpo.gov/fdsys/pkg/BILLS-113hr3370enr/pdf/BILLS-113hr3370enr.pdf

- Section 15 modifies the definition of “substantial improvements to a property” from 30 percent of its fair market value to 50 percent. A substantial improvement triggers full-risk rates, although the rate increases are phased in at 25 percent per year until full-risk rates are achieved.
 - Section 16 makes changes to the affordability study required under the BWA. Under the HFIAA, the deadline for completing the study is extended to September 21, 2015, and the following additional items must be considered in the study:
 - options for maintaining affordability if premiums for flood insurance coverage increase to an amount greater than 2 percent of the liability coverage under the policy
 - the effect that establishing catastrophe savings accounts would have on the long-term affordability of flood insurance coverage
 - options for modifying the surcharge under Section 8 (previously discussed), including consideration of homeowner income, property value, or risk of loss
 - Section 24 requires FEMA to designate a flood insurance advocate to ensure fair treatment of policyholders.
 - Section 25 changes the effective date for the mandatory escrow requirement for flood insurance premiums and fees from residential loans entered into or outstanding on or after July 6, 2014, to residential loans that are originated, refinanced, increased, extended, or renewed on or after January 1, 2016. For loans outstanding on January 1, 2016, but not subject to one of the exceptions to the escrow requirement, lenders and servicers must offer and make available to borrowers the option to escrow flood premiums and fees. Section 25 also expands the types of properties exempt from the escrow requirement to include:
 - business purpose loans secured by residential real estate
 - home equity lines of credit
 - loans with a term of less than 12 months
 - nonperforming loans
 - subordinate loans secured by the same residential real estate
 - loans secured by a condominium covered by a condominium association policy
 - Section 26 requires FEMA to establish guidelines that provide alternative mitigation measures for buildings that cannot be elevated, including building materials and floodproofing.
 - Section 28 requires FEMA to clearly communicate to individual property owners the cost of full risk-based premiums, whether or not the owners pay the full actuarial rates.
 - Section 30 requires FEMA to consult with local communities before undertaking a remapping and to discuss the mapping models FEMA will be using. This section also requires FEMA to notify congressional representatives for affected districts, prior to the issuance of any preliminary map, of community outreach schedules and the estimated number of properties that will be affected by proposed map changes.
- Additional information on the HFIAA and its implementation is available on FEMA's website at <http://www.fema.gov/flood-insurance-reform>.

REGULATORY CALENDAR*

Effective Date	Implementing Regulation	Regulatory Change	Outlook Live Webinar
†	Various	Interagency proposal to establish minimum requirements for appraisal management companies	
†	Reg. E	Consumer Financial Protection Bureau (CFPB) proposal to extend until July 21, 2020, temporary provision allowing use of estimates for foreign remittance transfer pricing disclosures	
8/1/15	Regs. X and Z	Final rule integrating Real Estate Settlement and Procedures Act (RESPA) and Truth in Lending Act (TILA) mortgage disclosures	
1/18/14	Reg. B	Final rule on Dodd-Frank Act appraisal requirements under the Equal Credit Opportunity Act	
1/18/14**	Reg. Z	Final rule exempting subset of higher-priced mortgage loans (HPMLs) from appraisal requirements	
1/18/14	Reg. Z	Final rule on Dodd-Frank Act appraisal requirements for HPMLs	
1/10/14 (interim final rule)	Regs. X and Z	Amendment to RESPA and TILA mortgage rules	
1/10/14	Regs. X and Z	Final rule on Dodd-Frank Act requirements for high-cost mortgages and homeownership counseling	
1/10/14	Reg. Z	Final rule delaying effective date of Dodd-Frank Act prohibition on single-premium credit insurance	
1/10/14	Reg. Z	Final rule on Dodd-Frank Act ability-to-repay/qualified mortgage rule CFPB later amended the rule to clarify inclusion of loan originator compensation in points and fees test. CFPB also amended rule in June 2013 concerning ATR and loan servicing rules.	12/4/13
1/10/14	Reg. Z	Federal Housing Finance Agency announcement limiting Fannie Mae/Freddie Mac loan purchases to Qualified Mortgages	
1/10/14	Regs. X and Z	July 2013 final rule amending certain aspects of Dodd-Frank Act mortgage rules issued in January 2013	
1/10/14, except 1/1/14 and 1/18/14 for certain provisions	Regs. B, X, and Z	September 2013 final rule amending certain aspects of Dodd-Frank Act mortgage rules	
1/1/14	Reg. Z	Annual dollar amount adjustments to TILA	
1/1/14***	Reg. Z	Final rule on Dodd-Frank Act requirements for loan originator compensation, mandatory arbitration, Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act), and single-premium credit insurance	
1/1/14	Reg. C	Annual adjustment to asset-size exemption threshold for Home Mortgage Disclosure Act requirements	
1/1/14	Reg. Z	Annual adjustment to asset-size exemption threshold for escrows for HPMLs	

† Rulemaking proposals generally do not have an effective date.

* Links to the regulatory changes are available in the online version of *Outlook* at www.tinyurl.com/calendar-cco.

** For manufactured homes, the effective date for the HPML appraisal requirement is July 18, 2015.

*** The amendment for mandatory arbitration was effective on June 1, 2013; amendments for SAFE Act and single-premium credit insurance took effect January 10, 2014.

ADDRESS SERVICE REQUESTED

CALENDAR OF EVENTS 2014

- | | |
|-----------------|--|
| August 27 | Interagency CRA Workshop
Federal Reserve Bank of Chicago
Cosponsored by the Office of the Comptroller of the Currency
and the Federal Deposit Insurance Corporation
Chicago, IL |
| September 18 | Interagency CRA Workshop
Federal Reserve Bank of Minneapolis
Cosponsored by the Office of the Comptroller of the Currency
and the Federal Deposit Insurance Corporation
Minneapolis, MN |
| September 22–23 | Shift Innovation: Community Development Conference
Federal Reserve Bank of Kansas City
Kansas City, MO |
| October 16–17 | FDIC 4th Annual Consumer Research Symposium
L. William Seidman Center
Hove Auditorium
Arlington, VA |