

# CONSUMER COMPLIANCE OUTLOOK®

## SECOND QUARTER 2015 INSIDE

### Managing Risk Throughout the Product Life Cycle

Introduction .....	2
Strategic Considerations .....	4
Product Design .....	5
Marketing .....	6
Product Delivery .....	7
Origination or Consummation .....	8
Product Use and Duration .....	9
Termination .....	10
Conclusion .....	10
Regulatory Calendar .....	11
News from Washington .....	12
On the Docket .....	14
Calendar of Events .....	16

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



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## MANAGING RISK THROUGHOUT THE PRODUCT LIFE CYCLE

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Welcome to the seventh anniversary issue of *Consumer Compliance Outlook*. This issue is dedicated to product risk management, the process by which a financial institution identifies, controls, and mitigates risks for its products and services. The Federal Reserve has published several articles on managing risks associated with new products and services in its *Community Banking Connections*<sup>1</sup> and *FedLinks*<sup>2</sup> publications, reflecting a safety and soundness perspective. This edition of *Consumer Compliance Outlook* leverages those articles and examines specific consumer compliance-related risks in greater detail throughout the product life cycle.

Product risk management can be approached in different ways. In this issue, we present a framework for evaluating product risk based on the product life cycle. The cycle begins when a product or service is conceptualized and ends when the institution stops offering it or the consumer stops using it (voluntarily or involuntarily). Each stage of the cycle can be subject to its own risks and challenges, so this article discusses various approaches to managing compliance risk at each product stage. For example, when a lender forecloses on a defaulted residential mortgage loan (the termination phase), specific regulatory requirements that apply must be considered. In contrast, when a financial institution considers a marketing campaign for a new product or service, the institution should ensure that it has considered the applicable laws and regulations at that stage of the product life cycle. The framework we discuss here — focusing on the product life cycle — is simply one approach to the process of product risk management. While this framework references new products and services, it may also be useful for managing the compliance risk of existing products and services.

The format of this issue is slightly different from our regular format. Since we are devoting the entire issue to product risk management, we are dividing each stage of the product life cycle into individual chapters. For easy reference, we have listed the chapters on the table of contents on this page.

<sup>1</sup>Teresa Curran, "Considerations When Introducing a New Product or Service at a Community Bank," *Community Banking Connections* (First Quarter 2013).

<sup>2</sup>"Introducing a New Product or Service," *FedLinks* (September 2014).

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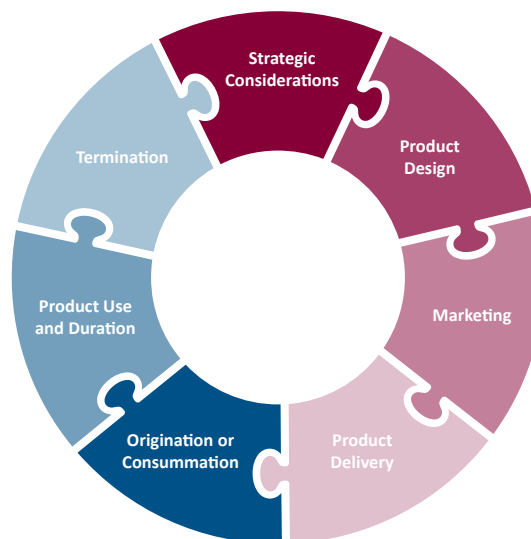
# INTRODUCTION

In today's highly competitive banking environment, a financial institution may believe that making changes to the products and services it offers provides an advantage over its rivals and a path to higher profits. While it is understandable that an institution may want to respond to a competitive environment with new products and services, this decision is not without risks. New products or services may be subject to complex regulatory requirements and may necessitate staff training, new disclosures and forms, updated policies and procedures, and system changes and testing. Changes to products and services should also be consistent with corporate strategic objectives. We have found that financial institutions that are successful in introducing new products or services employ a structured and repeatable process to manage any associated compliance risks. "By considering risks before introducing new products and services, management can identify and mitigate them in advance and avoid potentially costly and unintended consequences."<sup>3</sup>

Although compliance risk is typically greater for new products than for existing ones, financial institutions must still be vigilant in conducting risk management for their current products as well. One approach is to consider compliance risks throughout a product's life cycle.

## The Product Life Cycle

The product life cycle consists of different stages that a product or service goes through from inception to termination. The following table details the different stages and provides an illustrative (though not exhaustive) list of factors to consider at each stage of the process to help manage consumer compliance risk.



Each of the following chapters discusses a stage in the life cycle process, associated risks at each stage, and some of the management considerations at that specific stage.

<sup>3</sup> Teresa Curran, "Considerations When Introducing a New Product or Service at a Community Bank," *Community Banking Connections* (First Quarter 2013).

# THE PRODUCT LIFE CYCLE

STAGE	DEFINITION	CONSIDERATIONS
Strategic Considerations	Incorporates the strategic analysis behind an established, new, or modified product: this includes analyzing the strategic fit for the institution and its customers, as well as any components tied to product development (controls, compensation, platforms, etc.) and the overall benefit of the product to the institution and to consumers	<ul style="list-style-type: none"> <li>• Strategic goals and areas of expertise</li> <li>• Involvement of the board of directors, management, business line, legal, and compliance</li> <li>• Regulations or guidance</li> <li>• Emerging issues related to the product, including legal activity</li> <li>• Processes (developing procedures and operating systems, training staff, monitoring activities, and setting controls)</li> <li>• Use and role of third parties</li> </ul>
Product Design	Addresses the process of developing the actual product and specific considerations such as profitability and fee structure	<ul style="list-style-type: none"> <li>• Target market</li> <li>• Relationship to other products</li> <li>• Applicability of laws and regulations</li> <li>• Types of fees assessed</li> <li>• Delivery systems</li> </ul>
Marketing	Outlines the manner in which the product is targeted and marketed	<ul style="list-style-type: none"> <li>• Advertising</li> <li>• Cross-selling to customers</li> <li>• Targeting solicitations</li> </ul>
Product Delivery	Incorporates the components of the initial interface, including the selling and/or application process	<ul style="list-style-type: none"> <li>• Steering risk</li> <li>• Applications</li> <li>• Disclosures</li> <li>• Fees and terms</li> <li>• Role of compensation and incentives</li> </ul>
Origination or Consummation	Describes the process by which a customer qualifies for and obtains the product or service	<ul style="list-style-type: none"> <li>• Disclosures</li> <li>• Incentives and compensation structures</li> <li>• Pricing and underwriting discretion</li> </ul>
Product Use and Duration	Incorporates any and all aspects of a product after the origination or consummation stage; includes servicing, maintenance, dispute and resolution, changes in terms, default or misuse, additional fees, or other costs	<ul style="list-style-type: none"> <li>• Periodic statements and disclosures</li> <li>• Servicing practices and third-party servicers</li> <li>• Communications</li> <li>• Repayment options</li> <li>• Mobile banking platforms</li> <li>• Delivery systems</li> <li>• Complaints</li> </ul>
Termination	Addresses the process of the consumer voluntarily discontinuing use of the product, or the institution's process of discontinuing the product, or any other process in which the relationship between the consumer and the product ends	<ul style="list-style-type: none"> <li>• Communications</li> <li>• Procedures and practices</li> <li>• Loss mitigation, collection, and foreclosure</li> </ul>



# CHAPTER 1 – STRATEGIC CONSIDERATIONS

## BOARD AND SENIOR MANAGEMENT INVOLVEMENT

*“Educating and engaging board members can be valuable in the strategic planning process. Conversely, jumping into a new product or business line without effective challenge from board members can result in future headaches.”*

—“Financial Institution Strategies in the New Year: Trends and Examples” by Cathy Lemieux, *Community Banking Connections* (First Quarter 2014)

The products and services that a financial institution offers reflect the board’s and senior management’s compliance risk appetite and should align with the institution’s strategic plan and its level of expertise. It is important that all key stakeholders — directors, compliance officers, marketing officers, general counsel, operations management, and other senior management — be involved in strategic product decisions. Fully engaging key stakeholders enhances the process of identifying and managing risks.

It is helpful to articulate strategic goals for new products and services with measurable objectives (e.g., to increase market share or to increase noninterest income) and to identify the expected benefit to customers. The goals should be vetted with the board and senior management who need to consider the following issues:

- The financial institution’s risk appetite
- Its areas of expertise and its ability to deliver the new product or service
- Consumers’ perceived need for the product
- Current federal and state consumer protection laws, regulations, and guidance
- Financial institution resources
- Anticipated future regulatory requirements<sup>4</sup>
- Legal challenges related to the product or service, including lawsuits, consumer complaints, or public enforcement actions

From a supervisory standpoint, compliance examiners will often evaluate new products and services because they can

increase consumer compliance risk.<sup>5</sup> Management teams are encouraged to discuss proposed new products and services with their regulators to ensure that any regulatory concerns are addressed early in the decision-making process.

### *Resources and Expertise*

Another consideration is whether the institution has the resources and expertise to offer the product or service. We have seen management teams too often introduce product offerings without fully understanding the compliance requirements, the potential risks, the impact on customers, and the resources needed to successfully introduce and provide ongoing operational support for the new product or service. Potential factors to consider include the following:

- What knowledge is needed to effectively deliver the product or service?
- Does the financial institution currently possess, or can it cost effectively acquire, the required expertise and staffing level — not only in the business line but also in the compliance and audit areas?
- Can the financial institution’s computer systems handle the increased usage resulting from any new products or services?
- Does the financial institution currently possess, or can it cost effectively acquire, operational capacity to deliver the product or service (e.g., automated processing, centralized operations, use of third-party service providers)?
- What are the consequences of noncompliance or failure to deliver the product as promised?

### *Third Parties*

The decision to use third-party vendors for a product or service should be considered during the strategic planning process. When properly chosen and managed, third parties can provide an institution with valuable expertise and service that the institution cannot cost effectively provide on its own.<sup>6</sup> The depth and formality of a service provider risk management program will depend on a number of factors, including the complexity and materiality of the activity being outsourced.

<sup>4</sup>The Consumer Financial Protection Bureau (CFPB) publishes a semiannual regulatory agenda that provides information on its current rulemaking activities. The most recent agenda was released on May 22, 2015, and is available at <http://www.consumerfinance.gov/blog/spring-2015-rulemaking-agenda/>.

<sup>5</sup>See Federal Reserve Board, Consumer Affairs Letter (CA Letter) 13-19, “Community Financial Institution Risk-Focused Consumer Compliance Supervision Program,” November 18, 2013, available at <http://www.federalreserve.gov/bankinforeg/caletters/caltr1319.htm>.

<sup>6</sup>The Federal Reserve has published various resources pertaining to outsourcing risk, including CA Letter 13-21, “Guidance on Managing Outsourcing Risk,” December 5, 2013; a *Consumer Compliance Outlook* article by Anthony W. Ricks and Timothy P. Stacy, titled “Vendor Risk Management” (First Quarter 2011); and an Outlook Live webinar presented on May 2, 2012, titled “Vendor Risk Management — Compliance Considerations.”

Nonetheless, overreliance on third parties increases compliance risk if they are not adequately monitored. In our experience, financial institutions that do not have the requisite expertise or that do not ensure adequate oversight over their service providers are more likely to encounter challenges complying with the applicable regula-

tory requirements. In more serious instances, they may be exposed to third-party activities that adversely impact consumers, and such actions may result in adverse outcomes for the financial institution, including enforcement actions and penalties in the most extreme cases.

## CHAPTER 2 – PRODUCT DESIGN

Considerations at this stage include the specific features and benefits that will define the product. Examiners occasionally observe that compliance staff members are either absent from the product design and development process or involved only in the final review of a product before it is introduced or after it has been launched and transactions have been consummated. Successful management teams involve compliance staff throughout the entire design and development process.

Risk analysis in the design stage should focus on the specific requirements applicable to the particular product as designed. This helps to ensure that the institution develops an appropriate internal control infrastructure around the product to ensure compliance and to reduce the risk of harm to the consumer.

### *Fairness*

Successful products and services are designed with fairness in mind. This means delivering a value proposition in which the financial institution earns a profit while satisfying a customer need. It is more than simply complying with specific regulatory requirements, since technical compliance alone does not mean that a product is free from potential consumer harm. As the Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC) stated in their 2004 joint guidance for unfair or deceptive acts or practices (UDAP): “[T]here may be circumstances in which an act or practice violates section 5 of the FTC Act even though the institution is in technical compliance with other applicable laws, such as consumer protection and fair lending laws. [Financial institutions] should be mindful of both possibilities.”<sup>7</sup>

With the continued regulatory focus on fairness and consumer harm, institutions should always consider possible UDAP implications for their products and services and should address them early in the design process and monitor them throughout the product life cycle. Examples of questions to ask include:

- Does the product or service provide a win-win situation in which a customer need is satisfied and the bank earns a profit?
- Are the features or terms difficult for the customer to understand?
- Can communications about the product’s terms and features be made clearly, conspicuously, accurately, and timely?
- Does the product have unintended consequences that could be harmful to customers?<sup>8</sup>

### *Complexity*

As financial products and services become increasingly complex, the potential for consumer harm increases. Product features such as numerous conditional requirements, options, or variations contribute to complexity and the level of inherent compliance risk. When a product is overly complex, consumers may not understand all of its features or costs. Moreover, institutions may not be able to deliver the product as promised. Product attributes that may contribute to increased inherent compliance risk include:

- Offering large numbers of similar accounts — for example, credit cards or deposit accounts — that have many different features, terms, or conditions makes it challenging for the consumer to compare them and understand the differences.

<sup>7</sup>“Unfair or Deceptive Acts or Practices by State-Chartered Financial Institutions,” on p. 5 at <http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040311/attachment.pdf> (UDAP Guidance). In addition to the UDAP Guidance, the Federal Reserve issued Consumer Compliance Examination Procedures for the Unfair or Deceptive Acts or Practices Provisions of Section 5 of the Federal Trade Commission Act, available at <http://www.federalreserve.gov/boarddocs/caletters/2007/0708/caltr0708.htm>; hosted a webinar on March 5, 2013, through Outlook Live titled “UDAP — Analysis, Examinations, Case Studies, and Emerging Risks,” available at <https://www.consumercomplianceoutlook.org/outlook-live/2013/udap-analysis-examinations-case-studies-emerging-risks/>; and hosted a webinar on July 29, 2015, titled “Common Violations and Hot Topics,” available at <https://www.webcaster4.com/Webcast/Page/577/9474>.

<sup>8</sup>The CFPB is considering rules for payday loans, vehicle title loans, deposit advance products, and certain high-cost installment and open-end loans. See <http://www.consumerfinance.gov/newsroom/cfpb-considers-proposal-to-end-payday-debt-traps/>.

- Making product changes during the life cycle that will require additional disclosures and/or actions by the institution to comply with legal or regulatory requirements.
- Including features that can be explained only with disclosures that use dense, legal language and that span many pages.

To mitigate the risk involved with complex products and services, management may wish to consider simplifying product and service offerings during this stage.

## CHAPTER 3 – MARKETING

Marketing involves much more than simply advertising, and the associated compliance risks extend well beyond meeting technical advertising rules. For example, the Interagency Fair Lending Examination Procedures discuss fair lending risks that can arise in marketing, such as the use of marketing programs for residential loan products that exclude geographies within the institution's assessment or marketing area that have significantly higher percentages of minority group residents than the rest of the assessment or marketing area.<sup>9</sup> For this reason, it is important that compliance and marketing staff collaborate in developing all marketing strategies. Bringing compliance into the process early is a sound practice because it is more difficult and costly to make changes later in the process.

An illustrative list of marketing questions for management to consider includes:

- Is the product accurately portrayed and disclosed in all marketing materials (this would include not just advertising but scripts, training materials, and similar items)?
- Can a consumer readily understand and reap the benefits of the product?
- Has staff been appropriately trained to sell the product?
- Did the compliance staff participate in, or at least review, the marketing strategies and materials for compliance with applicable laws and regulations?

UDAP risk increases when products and services are targeted to potentially vulnerable populations. As stated in the UDAP Guidance:

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

been associated with abusive practices. Accordingly, financial institutions should take particular care in marketing credit and other products and services to the elderly, the financially vulnerable, and customers who are not financially sophisticated.<sup>10</sup>

### *Advertisements*

A number of federal laws and regulations apply to advertisements for consumer products and services. Some of the common applicable federal laws and regulations include (but are not limited to):

PRODUCT/SERVICE	LAW/REGULATION
All consumer financial products and services	UDAP
Credit	Equal Credit Opportunity Act (ECOA)/Regulation B Fair Housing Act Truth in Lending Act/Regulation Z
Deposit	FDIC regulations Truth in Savings Act/Regulation DD
Overdrafts	Electronic Fund Transfer Act/Regulation E Truth in Savings Act/Regulation DD
Credit reports	Fair Credit Reporting Act/Regulation V

It is important that advertisements, including those on the web and in social media,<sup>11</sup> are reviewed to ensure they comply with these and any other applicable laws or regulations. State law also may apply and should be considered.

<sup>9</sup>The 2009 Interagency Fair Lending Examination Procedures are available at <https://www.ffiec.gov/pdf/fairlend.pdf> on p. 12. The Federal Reserve hosts annual interagency fair lending hot topics sessions, which can be viewed at <https://www.consumercomplianceoutlook.org/outlook-live/archives/>.

<sup>10</sup> UDAP Guidance on pp. 8–9

<sup>11</sup> On December 11, 2014, the banking agencies issued guidance on compliance concerns for social media. See <https://www.ffiec.gov/press/pr121113.htm>.

## CHAPTER 4 – PRODUCT DELIVERY

During the product delivery stage, risk analysis should focus on the initial customer interaction, including the sales and application processes. The interaction will vary based on the institution's delivery channels, which may include traditional retail branches, the Internet, mobile applications, social media, brokers, referral sources, or other channels. It is essential that the risks within each delivery channel are identified. For example, institutions that use social media for product delivery may be exposed to increased reputation risk arising from any negative public reviews or comments. Activities that result in dissatisfied customers and/or negative publicity could harm the reputation and standing of the financial institution, even if the financial institution has not violated any laws. Therefore, financial institutions engaged in social media will want to be sensitive to, and properly manage, the reputation risks that arise from these activities.

During product delivery, compliance risks arise from regulatory requirements and restrictions regarding applications and the delivery and content of disclosures. For example, creditors must comply with the ECOA (Regulation B), which limits applicant information that may be collected, sets time frames for responding to applicants, and requires applicants to be notified of the action taken within a certain time frame.<sup>12</sup> As another example, Regulation E imposes disclosure requirements and substantive restrictions on overdraft programs. Generally speaking, a financial institution may not impose an overdraft fee for a point-of-sale transaction unless the consumer has been given a disclosure and has elected to opt in to the program.

Increasingly, financial institutions are using third parties to deliver the institution's products or are engaging in cobranding relationships in which third-party products are offered under the institution's name. In many of these arrangements, the third party is positioned directly between the financial institution and the customer and is closely involved in product and service delivery, often with unfettered access to consumers. Because the board and senior management are ultimately responsible for all aspects of

the institution's operations, effective due diligence and ongoing supervision of the third parties will help to mitigate risks from these arrangements. A proactive approach to oversight may also help financial institutions identify and correct issues as they arise and before they result in violations of law or harm to consumers. As discussed earlier, institutions should also consider fairness in product delivery.

Another key concern is the risk that a customer may be inappropriately steered to a particular product, especially one that involves higher cost or questionable benefit given the particular customer's circumstances. This risk is exacerbated when incentives, including compensation structures, reward employees or third parties for selling products. Appropriate disclosure of the product cost, features, and limitations to the consumer is critical for these types of products. For example, many institutions offer an overdraft line of credit. If a fee is incurred to transfer funds from the line of credit to the customer's savings or checking account to cover an overdraft, or if an annual fee is incurred to maintain the line of credit, the fees should be adequately disclosed. If customers do not receive a clear explanation of the overdraft program, or if misleading sales tactics are used, they may be unable to make an informed decision about the product and may expose the institution to UDAP risk.

To help manage product delivery risk, management should consider the following illustrative list of questions:

- Has the institution identified and addressed the risks associated with the applicable delivery channels?
- How will the institution comply with the laws and regulations that govern the sales and application processes?
- Are there compensation or other incentives that may drive risky behavior by employees?
- If third parties are used, is the oversight sufficient and effective?
- Will consumers receive all the necessary information to make an informed decision about the product during their initial interaction with the financial institution?

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<sup>12</sup> Regulation B, 12 C.F.R.1002

## CHAPTER 5 – ORIGATION OR CONSUMMATION

Once the customer has decided on a product or service, factors to consider at the origination or consummation stage include qualifying the customer for the product, providing the required disclosures, and ensuring the disclosures accurately reflect the contractual costs and terms of the transaction. Depending on the product or service being offered and its means of delivery, specific regulatory requirements, including disclosures, may apply. For example, an institution that originates products online will also generally provide the requisite disclosures through electronic means, subjecting the institution to the provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act).<sup>13</sup> For credit products, the institution should also consider potential fair lending risk. Inadequately controlled pricing and underwriting discretion increases the risk of disparities on a prohibited basis. Strong controls around product pricing and underwriting can mitigate these risks. Financial institutions should have well-documented qualification standards and pricing guidelines. Recognizing, documenting, and monitoring exceptions to policy are critical for mitigating fair lending risk.

When evaluating for UDAP risk during origination and consummation, the disclosures, product materials, and contractual agreements should be consistent with one another and clear, especially as they relate to the costs and terms of the transaction. In addition, disclosures or any other product information provided to the consumer should not include claims, representations, or statements that may mislead consumers about the cost, value, availability, cost savings, benefits, or terms of the product. As discussed earlier, compliant disclosures alone are not sufficient to prevent a UDAP finding if the consumer was otherwise misled about material product features.

To ensure the risk is appropriately managed during origination and consummation, management should consider the following illustrative list of questions:

- Has the financial institution considered the risks for each origination channel? For example, risks associated with retail originations will differ from wholesale originations.
- Has the financial institution considered the potential for fair lending and UDAP risk during product origination and consummation?
- Has the institution implemented appropriate controls to mitigate any perceived risk?
- Are the disclosures, product materials, and contractual agreements consistent with one another and clear?

[D]isclosures or any other product information provided to the consumer should not include claims, representations, or statements that may mislead consumers about the cost, value, availability, cost savings, benefits, or terms of the product.

<sup>13</sup> Outlook reviewed these requirements. See Jeffrey Paul and Gary Louis, “Moving from Paper to Electronics: Consumer Compliance Under the E-Sign Act.” *Consumer Compliance Outlook* (Fourth Quarter 2009).



## CHAPTER 6 – PRODUCT USE AND DURATION

The compliance risk of a product or service varies depending on its complexity and the duration of its use. The risk is typically greater for complex products such as a home equity line of credit or products that involve change over their life cycle (such as a variable rate mortgage), and when the usage period is long (such as a 30-year mortgage).

By contrast, products that only involve a single point-in-time transaction have less risk. For example, the servicing of a mortgage loan is subject to numerous regulatory requirements during its long life cycle. These can include frequent borrower communications (such as periodic statements and subsequent disclosures), processing of regular payments, and the need to abide by specific servicing rules. Conversely, a remittance transfer, once sent, will likely have regulatory risk only if a consumer files a dispute, which generally must be done within 180 days of the disclosed funds availability date.<sup>14</sup>

### *Regulatory Requirements and Guidance*

Depending on the product, service, or the delivery system used, specific regulatory requirements and restrictions may apply.

The more common requirements and restrictions may include, but are not limited to:

- Annual privacy notices
- Periodic statements

Subsequent disclosures may include those for:

- Changes in terms
- Account renewal/maturity
- Interest rate adjustment and/or payment change
- Force-placed insurance
- Adverse action

New servicing practices may include those for:

- Prompt crediting of payments
- Timely provision of payoff statements
- Error resolution and information requests
- Default monitoring and servicing of delinquent accounts
- Loss mitigation and foreclosure
- Debt collection

An institution should also consider guidance issued by regulatory agencies. For example, the federal banking agencies recently issued guidance on home equity lines of credit (HELOCs) nearing their end-of-draw periods.<sup>15</sup> As noted in the guidance, supervised institutions are expected to promote compliance with applicable laws and regulations and to have adequate risk management practices to monitor, manage, and control the risks in their HELOC portfolios as lines near their end-of-draw periods.

### *Complaints*

Regularly reviewing and evaluating customer complaints can provide insights into how well customers understand the institution's products and services. Complaints can come from a variety of sources, including customer service calls, written complaints to the financial institution or its primary regulator, customer reviews, or social media.

Because complaints can serve as an early indicator of potential concerns, managing a product or service successfully will include a process to monitor and analyze complaints. While it is important to address the specific concerns of any particular customer, determining whether an issue is systemic and whether other customers may be affected is also important.

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<sup>14</sup> 12 C.F.R. §1005.33(b)(1)(i)

<sup>15</sup> CA Letter 14-4, available at <http://www.federalreserve.gov/bankinfo/reg/srletters/sr1405.htm>

## CHAPTER 7 - TERMINATION

The last phase of the product life cycle involves terminating a product or service. This may occur when a product has a fixed maturity, a customer voluntarily closes an account, or bank management decides to discontinue a product or service. Over time, especially in an environment of rapid technological change, customer demand for certain products and services may change. For example, consumers have largely shifted away from using paper checks and are relying instead on bill pay services, debit and credit cards, and, increasingly, mobile payments to make payments or purchase goods and services.

An illustrative list of factors to consider during both customer and financial institution initiated termination of a product or service includes:

### *Financial Institution Initiated Termination*

- Does the financial institution provide advance notice to customers to allow them sufficient time to migrate to another product or service?
- Is the institution complying with any applicable regulatory requirements? For example, the Real Estate Settlement Procedures Act (Regulation X) requires mortgage loan servicers to notify mortgage borrowers at least 15 days in advance when the servicer

changes.<sup>16</sup> Similarly, the Truth in Lending Act (Regulation Z) requires that if the owner of a loan sells or transfers it, the new owner must notify the borrower of the transfer.<sup>17</sup>


- Has the institution trained staff to answer questions from affected customers?
- Is the institution discontinuing a credit product entirely or closing only certain accounts? If the latter is the case, would the closure criteria disproportionately affect customers on a prohibited basis?
- Are the institution's foreclosure processes and controls effective and do they comply with consumer protection regulations?<sup>18</sup>

### *Product Maturity and Voluntary Account Closures*

- Does the institution respond accordingly to voluntary account closures? For example, Regulation Z<sup>19</sup> contains specific requirements for responding to payoff requests.
- Does the financial institution comply with applicable regulatory and contractual agreements at product maturity or voluntary account closure? For example, when a certificate of deposit account automatically renews, the financial institution may be required to send a maturity notice and renew the certificate of deposit according to the previous account agreement.<sup>20</sup>

## CONCLUSION

Innovation, market conditions, and consumer demand will always lead to new products and services in the financial services industry. The institutions that are most successful in introducing new products and services consider consumer compliance risk throughout the product life cycle. This framework considers various institutional, legal and regulatory, and environmental risk factors that may be

present at each life cycle stage of the product or service. This comprehensive approach for managing compliance risk helps to ensure that financial institutions can obtain the benefits of the new products and services and avoid the unintended consequences that can derail an institution's product strategy. Specific issues and questions should be raised with your primary regulator. 

<sup>16</sup> 12 C.F.R. §1024.33(b)(3)

<sup>17</sup> 12 C.F.R. §1026.39

<sup>18</sup> CA Letter 13-6 "Minimum Standards for Prioritization and Handling Borrower Files with Imminent Scheduled Foreclosure Sale," issued April 23, 2013, sets forth guidance on sound business practices for residential mortgage servicing that Federal Reserve-supervised financial institutions are expected to address in their collections, loss mitigation, and foreclosure processing functions.

<sup>19</sup> 12 C.F.R. §1026.36(c)(3)

<sup>20</sup> 12 C.F.R. §1030.5

## REGULATORY CALENDAR\*

Effective Date	Implementing Regulation	Regulatory Change	Outlook Live Webinar
1/1/16	Reg. H	Final rule implementing provisions of the Homeowners Flood Insurance Affordability Act	
10/3/15	Regs. Z and X	Final rule extending integrated disclosure timing requirements for rate locks and requiring placement of the Nationwide Mortgage Licensing System and Registry (NMLSR) ID on the Truth in Lending Act and Real Estate Settlement Procedures Act (TILA-RESPA) integrated disclosure (TRID) rule	6/17/14 8/26/14 10/1/14 11/18/14 5/26/15
8/31/2015	N/A	Final rule defining larger nonbank participants in automobile financing market	
8/10/15	Reg. Z	Final rule for minimum requirements for appraisal management companies	
12/1/14	Reg. E	Final rule defining larger nonbank participants in international money transfer market	
11/3/14	Reg. Z	Final rule on cure procedure for points and fees error for QMs	
10/28/14	Reg. P	Final rule to streamline privacy notices	
†	Regs. Z and X	Proposal to make nine changes to mortgage servicing rules under the TILA and the RESPA	
†	Reg. Z	Proposal to expand small creditor qualified mortgage (QM) and small creditor balloon QM	
†	Regs. E and Z	Proposal to provide consumer protection for prepaid cards	
†	Reg. BB	Proposal to revise Interagency Community Reinvestment Act Q&As	
†	Reg. C	Proposal to add new Home Mortgage Disclosure Act data fields to Reg. C	
†	Various	Interagency proposal under Economic Growth and Regulatory Paperwork Reduction Act to streamline regulations of the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation	
†	Reg. E	Consumer Financial Protection Bureau extends temporary provision allowing use of estimates for foreign remittance transfer pricing disclosures until July 21, 2020	

\* Links to the regulatory changes are available in the online version of *Outlook* at [tinyurl.com/calendar-cco](http://tinyurl.com/calendar-cco).

† Rulemaking proposals generally do not have an effective date.

# NEWS FROM WASHINGTON: REGULATORY UPDATES\*

**The Consumer Financial Protection Bureau (CFPB) issues its Spring 2015 regulatory agenda.** On May 22, 2015, the CFPB released its Spring 2015 regulatory agenda, which updates the status of the regulatory issues and rulemakings on which the CFPB is currently working:

## Final Rule

- Completing a final rule under Regulation C to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act's (Dodd-Frank Act) amendments to the Home Mortgage Disclosure Act. The rulemaking proposal is available; the CFPB expects the final rule to be issued in August 2015.
- Completing a final rule under Regulation E to regulate prepaid financial products. The proposal is available; the CFPB expects the final rule to be issued in January 2016.
- Issuing a final rule on June 10, 2015, to supervise larger, nonbank participants in the consumer automobile financing and leasing markets, defined as nonbanks that annually originate at least 10,000 automobile loans, automobile loan refinancings, purchase of automobile loans, or leases. The rule became effective August 31, 2015.

## Prerule Stage

- Considering a rulemaking proposal to regulate payday, auto title, and other loans
- Considering a rulemaking proposal for overdrafts and related services
- Considering a rulemaking proposal to regulate debt collection
- Determining, as required by the Dodd-Frank Act, whether to issue regulations restricting mandatory arbitration clauses for financial products and services

**The CFPB delays the TILA/RESPA integrated disclosure (TRID) rule effective date until October 3, 2015.** On July 24, 2015, the CFPB issued a final rule to delay the effective date of the TRID rule from August 1, 2015, until October 3, 2015, and to make technical corrections to §1026.38(i)(8)(ii) and (iii)(A), and §1026.38(j)(1)(iv).

On a related note, the following five webinars on the TRID rule with presentations from the CFPB are available on the Outlook Live website (<https://consumercomplianceoutlook.org/outlook-live/archives>):

- The TILA-RESPA Integrated Disclosures, Part 1 — Overview of the Rule
- FAQs on the TILA-RESPA Integrated Disclosures, Part 2 — Various Topics
- FAQs on the TILA-RESPA Integrated Disclosures Rule, Part 3 — Completing the Loan Estimate
- The TILA-RESPA Integrated Disclosures, Part 4 — Completing the Closing Disclosure
- The TILA-RESPA Integrated Disclosure, Part 5 — Implementation Challenges and Questions

**The CFPB is in the early stages of a rulemaking to regulate payday loans, vehicle title loans, deposit advance products, and certain high-cost installment and open-end loans.** On March 26, 2015, the CFPB published an outline of a rulemaking proposal it is contemplating that would require lenders to consider repayment ability for these loan products. The press release stated that consumers using these products often end up in “debt traps” because the creditors offering them typically do not underwrite a consumer’s ability to repay the loan. Consequently, consumers often must choose to reborrow, default, or fall behind on other obligations. To address this issue, the CFPB is considering a proposal to regulate both short-term credit products that require full repayment within 45 days and longer-term credit products of more than 45 days in which the lender has access to repayment from the consumer’s deposit account or paycheck or holds a security interest in the consumer’s vehicle, and in which the all-in APR exceeds 36 percent. The CFPB is considering two regulatory approaches: “prevention” and “protection.” The prevention approach would incorporate an ability-to-repay element, including verification of the consumer’s income, major financial obligations, and borrowing history. Under the protection approach, lenders would have to comply with various restrictions designed to ensure that consumers can affordably repay their debt. Lenders would choose which approach to follow. The proposal under consideration would also restrict certain collection practices by requiring creditors to provide advance notice of at least three business days before submitting a payment request to the consumer’s financial institution or prepaid account. If the payment could not be collected after two attempts, the creditor could not initiate a third attempt unless the consumer provided a new authorization. More details on the proposals under consideration are available at [http://files.consumerfinance.gov/f/201503\\_cfpb\\_outline-of-the-proposals-from-small-business-review-panel.pdf](http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf).





**The CFPB proposes to expand Regulation Z's definitions of *small creditor* and *rural* to facilitate access to credit.**

On January 29, 2015, the CFPB proposed changes to its mortgage rules to facilitate mortgage lending by small creditors, particularly in rural and underserved areas. The CFPB issued several mortgage rules that became effective in January 2014, including the ability-to-repay/qualified mortgage (QM) rule. This rule defined five categories of QMs, three of which are only available to a *small creditor*, defined as a creditor with less than \$2 billion in assets that (with its affiliates) originates no more than 500 first-lien covered mortgages each year. Small creditor QMs offer more pricing and underwriting flexibility than the standard QM category. The proposal would expand the definition of small creditor by raising the origination threshold to 2,000 or fewer nonportfolio, first-lien covered mortgage loans in the prior calendar year (including affiliates). Under the proposal, loans held in a portfolio would not count toward the 2,000 loan threshold. The CFPB estimates that 700 additional creditors would qualify as small creditors under the proposed definition.

The proposal would also revise the definition of *rural*, which would impact several mortgage rules. Small creditors operating predominately in rural or underserved areas and meeting certain other requirements are not required to maintain escrows for first-lien, higher-priced mortgage loans; they can offer high-cost mortgage loans with a balloon feature (the Home Ownership Equity Protection Act generally prohibits balloon features for high-cost loans) and can permanently offer portfolio-held balloon loans that are QMs (QMs generally cannot have a balloon feature; other small creditors that do not operate predominantly in rural or underserved

areas are temporarily eligible to originate balloon-loan QMs). As currently defined, a county is considered to be rural during a calendar year if it is not in a metropolitan statistical area (MSA) and it is not in a micropolitan statistical area (micro area) that is adjacent to an MSA, as defined by the Office of Management and Budget. The CFPB proposes to expand the number of areas considered rural by including areas that the U.S. Census Bureau classifies as rural on a census tract basis. Thus, the definition of rural would be expanded to include areas in census blocks that are not in an urban area, as defined by the Census Bureau. The CFPB estimates that the number of rural small creditors would increase by approximately 1,700 if the proposal were adopted. The proposal also would revise certain timing elements related to the small creditor and rural definitions. The comment period closed on March 30, 2015. The proposal indicates that when the final rule is adopted, it will become effective January 1, 2016.

**The CFPB makes minor changes to “know before you owe” mortgage rules.**

On January 20, 2015, the CFPB issued a final rule to make two minor modifications to the TRID rules. The changes were proposed in October 2014 to address the timing of when consumers must receive updated disclosures after locking in an interest rate and the manner in which consumers receive information regarding certain construction loans.

Under the January 2015 final rule, creditors must provide a revised loan estimate within three business days after a consumer locks in a floating interest rate. The original rule required creditors to provide the revised loan estimate on the date that the rate is locked in. For new construction loans, a minor addition has been made to the loan estimate form.

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# ON THE DOCKET: RECENT FEDERAL COURT OPINIONS\*

## Regulation Z — Truth in Lending Act (TILA)

**Seventh Circuit addresses when electronic mortgage payments must be credited to borrowers' accounts.** *Fridman v. NYCB Mortgage Co., LLC*, 780 F.3d 773 (7th Cir. 2015). A divided panel held that a borrower's electronic mortgage payment initiated on a loan servicer's website must be credited on the date that the electronic authorization to debit a borrower's bank account is received. The plaintiff's mortgage payment was due on the first day of each month with a 15-day grace period before a late fee would be imposed. The plaintiff sent her December 2012 payment electronically through the defendant loan servicer's website using the automated clearing house (ACH) network on either December 13, 2012 (after the 8:00 p.m. cutoff) or on the morning of December 14, 2012 (a Friday). The servicer's policy was to credit an ACH payment authorization two business days after it was received, so the payment was not credited until December 18, 2012 (a Tuesday), the same day the plaintiff's bank account was debited and three business days after the grace period expired.

Because the payment was deemed late as of this date, the bank imposed a late fee of \$88.54. The plaintiff's lawsuit alleged that the payment was timely under Regulation Z's mortgage payment crediting rules, and therefore, the servicer violated the TILA by imposing the late fee. As the court explained, the "TILA generally requires mortgage servicers to credit payments to consumer accounts 'as of the date of receipt' of payment, unless delayed crediting has no effect on either late fees or consumers' credit reports." 15 U.S.C. §1639f(a), 12 C.F.R. §1026.36(c)(1)(i).

The court focused on Comment 1026.36(c)(1)(i)-3 of the Regulation Z Official Staff Commentary to decide this issue: "The 'date of receipt' is the date that the payment instrument or other means of payment reaches the mortgage servicer. For example, payment by check is received when the mortgage servicer receives it, not when the funds are collected." The court interpreted this to mean that electronic payments must be credited on the date — the "date of receipt" — that the servicer receives the electronic authorization (i.e., the payment instrument or other means of payment) to collect the payment. The court noted that this rule applies only to electronic payments initiated directly on a servicer's website. It would not apply to electronic payments initiated through third parties, such as a bill-payment service provided by a consumer's bank. In those other situations, the rule is that the electronic payment need not be credited until the consumer's electronic fund transfer (and not solely the consumer's electronic authorization) is actually received.

## Regulation X — Real Estate Settlement Practices Act (RESPA)

**Eleventh Circuit rejects RESPA claims alleging nominal and marked-up settlement services.** *Clements v. LSI Title Agency, Inc.*, 779 F.3d 1269 (11th Cir. 2015). The plaintiff refinanced a mortgage, and defendant LSI Title Agency (LSI) was hired by the lender to perform closing services, including providing a closing attorney. The plaintiff later filed a class action lawsuit alleging two RESPA violations: 1) that LSI provided only nominal services because it merely hired the attorney who performed the closing, for which it charged a \$300 settlement fee; and 2) that LSI violated the prohibition against giving or accepting any portion, split, or percentage of any settlement charge when it charged the borrower \$125 for government recording, a service for which it only paid \$40 to a Georgia state government agency. The RESPA states that "[n]o person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service ... other than for services actually performed." 12 U.S.C. §2607(b).

Although the RESPA prohibits charging an unearned fee, the court held that LSI performed a service by retaining the attorney to conduct the closing because under RESPA "arranging for [a] third party contractor[ ] to perform [a service] is itself a service." With respect to the markup, the court — explaining that "a markup of a charge to the consumer violates [RESPA] when [a] mortgage service provider accepts an unearned portion of that charge" — ruled that LSI neither gave nor accepted any portion, split, or percentage of any charge other than for services that it actually performed. In so doing, it concurred with the majority of federal appeals courts that have addressed the issue by concluding that Congress, in RESPA Section 2607(b), neither prohibited markups nor required that "a mortgage lender shall only charge the consumer what is paid to a third party for a real estate settlement service."



## Fair Credit Reporting Act (FCRA)

**Seventh Circuit clarifies meaning of “willful noncompliance” for purposes of awarding FCRA damages.** *Redman v. RadioShack Corp.*, 768 F.3d 622 (7th Cir. 2014). In a consolidated appeal involving two class action lawsuits, the Seventh Circuit clarified the standard of willful noncompliance under the Fair Credit Reporting Act (FCRA). The lawsuits involved two retailers, RadioShack and Shoe Carnival, that violated the prohibition in the Fair and Accurate Credit Transactions Act (FACTA) against printing a credit card expiration date on a receipt provided to a cardholder at the point of the sale or transaction. 15 U.S.C. §1681c(g)(1). RadioShack printed the entire expiration date, while Shoe Carnival printed the expiration month (but not the year). RadioShack settled the case, but certain class members objected to the lower court’s approval of the settlement. In both cases, the Seventh Circuit had to determine if the violations were willful.

Determining if the FCRA violations were willful was relevant to calculating a plaintiff’s damages. For a negligent violation, a plaintiff can recover only actual damages and attorney’s fees. However, per 15 U.S.C. §1681n(a)(1), for a willful violation, a court must award either actual damages or statutory damages for a minimum amount of \$100 or a maximum amount of \$1,000. Punitive damages may also be imposed for a willful violation.

The Seventh Circuit stated that acting “willfully” refers to conduct that creates “an unjustifiably high risk of harm that is either known or so obvious that it should be known.” RadioShack’s conduct was deemed to be willful because it had been sued in 2008 for the same conduct under an Ohio state law similar to the FCRA, but it failed to take adequate precautions to prevent a repeat violation. However, the court found that Shoe Carnival’s violation was not willful because the retailer believed that the statute prohibited printing the entire expiration date, and it printed only the expiration month. The court found that this interpretation, while legally incorrect, was plausible because the statute does not define the “expiration date.” The court therefore affirmed the district court’s finding that Shoe Carnival did not act willfully.

**Consumer reporting agency’s duty to reinvestigate disputed information.** *Collins v. Experian Information Solutions, Inc.*, 775 F.3d 1330 (11th Cir. 2015). A consumer filed a lawsuit against Experian, a consumer reporting agency, claiming that it had failed to conduct a reasonable reinvestigation of his dispute for a debt that a debt collector had acquired. When the consumer first saw the debt on his Experian credit report, he disputed it, noting that a court had previously ruled in his favor in a collection lawsuit filed by the debt collector. Experian asked the debt collector to investigate, and the debt collector wrongly responded that the debt was still valid.

When the consumer later checked his Experian credit report and saw that the debt was still listed, he sued Experian for violating 15 U.S.C. §1681i(a), which requires a consumer reporting agency to conduct a reasonable “reinvestigation” of disputed information in a consumer’s credit file to determine whether the disputed information is inaccurate. (The Fair Credit Reporting Act (FCRA) creates a private right of action against consumer reporting agencies for negligent or willful violations of duties imposed by the statute.) The trial court granted Experian summary judgment on the plaintiff’s FCRA claims, holding that the consumer could only recover against Experian if the disputed debt had been published to a third party, which it had not done. But the Eleventh Circuit reversed and remanded the matter for further hearings, finding that when a consumer disputes information in his credit “file” — as distinguished from a “consumer report, which requires communication to a third party, while a ‘file’ does not” — and a consumer reporting agency fails to conduct a reasonable reinvestigation, the consumer is entitled to actual damages regardless of whether the disputed information was furnished by the consumer reporting agency to a third party.

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## CALENDAR OF EVENTS 2015

**September 24**

**Kansas Interagency CRA Roundtable**  
Federal Reserve Bank of Kansas City  
Wichita, KS

**September 24–25**

**Fifteenth Annual Chicago Payments Symposium**  
Federal Reserve Bank of Chicago  
Chicago, IL

**October 1–2**

**New Perspectives on Consumer Behavior in Credit and Payments Markets**  
Payment Cards Center and Research Department  
Federal Reserve Bank of Philadelphia  
Philadelphia, PA

**October 8**

**Colorado Interagency CRA Roundtable**  
Federal Reserve Bank of Kansas City  
Denver Branch  
Denver, CO

**October 14**

**Missouri Interagency CRA Roundtable**  
Federal Reserve Bank of Kansas City  
Kansas City, MO