

CONSUMER COMPLIANCE OUTLOOK®

A FEDERAL RESERVE SYSTEM PUBLICATION FOCUSING ON CONSUMER COMPLIANCE TOPICS

INSIDE

Servicemember Financial Protection: An Overview of Key Federal Laws and Regulations	10
Regulatory Calendar	19
News from Washington	20
On the Docket	22
Calendar of Events.....	24

KEEPING FINTECH FAIR: THINKING ABOUT FAIR LENDING AND UDAP RISKS

BY CAROL A. EVANS, ASSOCIATE DIRECTOR, DIVISION OF CONSUMER AND COMMUNITY AFFAIRS, THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM¹

Fintech is the latest wave in the continuing technological evolution of financial services. Fintech has already produced real benefits to consumers, including increased speed, convenience, and new product offerings that make it easier for consumers to manage their financial lives. Fintech may also offer ways to bring banking and new financial products to underserved communities, including products and accounts that help the underbanked manage their finances more easily, budget, and save.

Additionally, many firms are exploring ways to leverage new data and analytic techniques to extend credit to more consumers. It may be possible to extend responsible and fair access to credit to more consumers who do not have a traditional credit history and who would otherwise be denied access to prime credit. The Consumer Financial Protection Bureau (CFPB) has found that approximately 26 million Americans are credit invisible, which means that they do not have a credit record, and another 19.4 million do not have sufficient recent credit data to generate a credit score.²

Some in the fintech world see an enormous opportunity to improve access to credit on fair terms but are frustrated that the complexities of consumer compliance laws may thwart progress, especially in the areas of fair lending and unfair or deceptive acts or practices (UDAP). On the other hand, some stakeholders, including consumer advocates, are alarmed that some firms are jumping headfirst into new data and products without adequately evaluating the risks. They believe that some fintech trends may not only be unfair to certain consumers but could serve to exacerbate existing inequities in financial access and result in the digital equivalent of redlining.

The purpose of this article is to offer some general guideposts for evaluating UDAP and fair lending risk related to fintech, with a focus on alternative data. Increasing fluency with fair lending and UDAP concepts can help integrate consumer protection considerations into the early phases of business development, which can ensure effective compliance and save everyone time in the long run. In fact, we often hear consumer compliance professionals express frustration that they are brought into the process late when it is harder to course correct. We encourage business executives to view their compliance colleagues as key partners who can provide valuable advice at every stage of the business development process. Of course, both fair lending and UDAP are broad areas of the law where sound legal analysis depends on the specific facts and circumstances. Thus, the summary that follows is intended to offer general questions to help guide thinking early on in the business development process. It is not a substitute for the careful legal review that should be part of any effective consumer compliance program.³

CONTINUED ON THE NEXT PAGE

Outlook Advisory Board

Karin Bearss

Vice President, SRC
Federal Reserve Bank of Minneapolis

John Insley Jr.

Vice President, Banking Supervision
Federal Reserve Bank of Dallas

Robin Myers

Chair, Outlook, Vice President, SRC
Federal Reserve Bank of Philadelphia

Andrew Olszowy

Assistant Vice President, S&R
Federal Reserve Bank of Boston

Outlook Staff

Editors..... Kenneth Benton
Barbara Brynko
Designer Theresa Fleming
Research Assistants Micah Spector
Laura Gleason
Project Manager..... Marilyn Rivera

Consumer Compliance Outlook is distributed to state member banks and bank and savings and loan holding companies supervised by the Board of Governors of the Federal Reserve System.

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

Kenneth Benton, Editor

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

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

Copyright 2017 Federal Reserve Banks. This material is the intellectual property of the Federal Reserve Banks and cannot be copied without permission. Produced by:



FEDERAL RESERVE BANK OF PHILADELPHIA

KEEPING FINTECH FAIR: THINKING ABOUT FAIR LENDING AND UDAP RISKS

CONTINUED FROM PAGE 1

LAYING THE FOUNDATION: FAIR LENDING AND UDAP BASICS

Before delving into the possibilities of fintech, it is helpful to first review the basics of fair lending and UDAP.

Fair Lending: The Equal Credit Opportunity Act and the Fair Housing Act

The Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA) are the two key federal fair lending laws. ECOA prohibits credit discrimination on the basis of race, color, religion, national origin, sex, marital status, age, receipt of income from any public assistance program, or because a person has exercised certain legal rights under ECOA and other financial statutes. ECOA applies to both consumer and commercial credit. The FHA applies to credit related to housing and prohibits discrimination on the basis of race or color, national origin, religion, sex, familial status, and handicap.

The fair lending laws broadly prohibit two kinds of discrimination: disparate treatment and disparate impact. In some instances, both theories may apply. Disparate treatment occurs when a lender treats a consumer differently because of a protected characteristic. Disparate treatment ranges from overt discrimination to more subtle differences in treatment that can harm consumers and does not need to be motivated by prejudice or a conscious intent to discriminate. The Federal Reserve has made numerous referrals to the U.S. Department of Justice (DOJ) involving disparate treatment in pricing where bank employees charged higher fees or interest rates on loans to minorities than to comparably qualified nonminority consumers. These referrals have resulted in several DOJ enforcement actions. These cases typically involve situations in which bank employees had broad discretion to set interest rates and fees and could increase their own compensation by charging borrowers more.⁴

Disparate impact occurs when a lender's policy or practice has a disproportionately negative impact on a prohibited basis, even though the lender may have no intent to discriminate and the practice appears neutral.⁵ A policy or practice that has a disparate impact may violate the law, unless the policy or practice meets a legitimate business necessity that cannot reasonably be achieved by a means that has less impact on protected classes.⁶ Factors that may be relevant to business necessity could include cost and profitability.⁷ For example, the CFPB and DOJ brought a discrimination enforcement action against a wholesale lender in 2015.⁸ In that case, the CFPB and DOJ alleged that the lender's policies with respect to broker fees and its pricing practices resulted in minorities paying more for loans than nonminority borrowers and that the policies could not be justified by legitimate business necessity. In many cases, it is possible to frame an issue of possible discrimination as either disparate impact or disparate treatment. In fact, many enforcement actions do not indicate which theory was used. So, it is helpful to be familiar with both theories.

As we will explore further, fintech may raise the same types of fair lending risks present in traditional banking, including underwriting discrimination, pricing discrimination, redlining, and steering. Although some fintech trends may decrease certain fair lending risks, other trends could amplify old problems or create new risks.



Unfair or Deceptive Acts or Practices

Section 5 of the Federal Trade Commission Act prohibits unfair or deceptive acts or practices.⁹ The Dodd–Frank Wall Street Reform and Consumer Protection Act prohibits unfair, deceptive, or abusive acts or practices.¹⁰ Many states also have their own UDAP laws. Deceptive acts or practices are representations, omissions, or practices that are likely to mislead a consumer acting reasonably under the circumstances and are material (i.e., are likely to affect the consumer’s conduct or decision with respect to a product or service). Unfair acts or practices are those that cause or are likely to cause substantial injury to consumers that consumers cannot reasonably avoid. Additionally, the substantial injury must not be outweighed by countervailing benefits to consumers or competition.

Deception in the financial services industry often involves misrepresenting the terms or costs of financial products or services. For example, in 2015, the Federal Reserve announced a public enforcement action against a provider of financial aid and reimbursement services to colleges and universities and demand deposit account services to students.¹¹ The Federal Reserve alleged, among other things, that the company failed to provide information

about the fees, features, and limitations of its product before requiring students to decide how to receive their financial aid disbursement. Another example is the enforcement action of the Federal Trade Commission (FTC) and the Federal Deposit Insurance Corporation (FDIC) against CompuCredit,¹² which advertised credit cards to consumers with poor credit histories. The FTC alleged that CompuCredit violated the UDAP prohibition when it misrepresented the amount of credit that would be available to consumers when they received the card, failed to disclose upfront fees, failed to disclose that purchases that triggered the company’s risk algorithm could reduce a consumer’s credit limit, and misrepresented a debt collection program as a credit card offer.

The unfairness prohibition is also relevant to financial services. In another FTC case, a website operator gathered extensive personal information from consumers for purported payday loan applications and purchased applications from other websites.¹³ Consumers believed that they were applying for loans, but the operator sold their application information, including Social Security numbers and bank account information, to companies that fraudulently debited their bank accounts.

SOME QUESTIONS TO CONSIDER WHEN THINKING ABOUT FINTECH AND ALTERNATIVE DATA

Many fintech firms and banks are exploring new data sources as well as new analytical techniques, an approach sometimes referred to as big data. Big data does not have a uniform definition, but it generally refers to the analysis of large, complex data sets that are collected over time from different sources. These data sets, combined with developments in analytics, such as machine learning, can open up new approaches to data modeling. Instead of formulating a hypothesis and collecting data to test it, data sets can be analyzed to find patterns that may emerge.

Institutions should conduct a thorough analysis to ensure compliance with consumer protection laws prior to implementing new data and modeling methods.

Much has been written about the potential positive uses of big data to help businesses better serve consumers and to help policymakers solve social problems, as well as about potential concerns, such as fairness and accuracy.¹⁴ These concerns are not limited to financial services but extend broadly to both commercial and governmental uses of big data.¹⁵ In the criminal justice system, a model used by courts to predict recidivism has been criticized for potentially overpredicting the chance that black defendants would commit another crime.¹⁶ In the world of Internet advertising, researchers found that women were less likely to be shown ads for high-paying jobs.¹⁷ And, when Amazon initially launched same-day delivery, its algorithms excluded many minority neighborhoods from the service.¹⁸

So much depends on exactly which data are used, whether the data are accurate and representative, and how the data are used. A jarring reminder of the importance of representative data involves photo recognition software. Some photo software misclassified images of African Americans and Asian Americans, presumably because the data used to develop the software did not include sufficient diversity.¹⁹ Data also may reflect past biases. By way of illustration, if a hiring model for engineers is based on historical data, which may consist mostly of men, it may not adequately consider traits associated with successful

engineers who are women.²⁰ Thus, while statistical models have the potential to increase consistency in decision-making and to ensure that results are empirically sound, depending on the data analyzed and underlying assumptions, models also may reflect and perpetuate existing social inequalities. Thus, big data should not be viewed as monolithically good or bad, and the fact that an algorithm is data driven does not ensure that it is fair or objective.

To help evaluate alternative data in fintech, we suggest asking some questions early in the process. Before going further, it is important to underscore that institutions should conduct a thorough analysis to ensure compliance with consumer protection laws before implementing new data and modeling methods. The questions and discussion that follow are not offered to replace that careful analysis but may be helpful for institutions early in the business development process.

What Is the Basis for Considering the Data?

Is there a nexus with creditworthiness?

The first question to ask before using new data is the basis for considering the data. If the data are used in the credit decision-making process, what is the nexus with creditworthiness? Some data have an obvious link to creditworthiness and are logical extensions of current underwriting practices, while others are less obvious. For example, for small business lending, some creditors are developing new underwriting models based on financial and business records.²¹ These models consider many of the same types of data used in traditional underwriting methods but in an empirically derived way based on analyzing thousands of transactions.²² Some models may be expressly developed for certain businesses, such as dry cleaners or doctors' offices. In essence, these models are expanding automated underwriting — long used for mortgages and other consumer lending products — to small business loans. Similarly, for consumer loans, some firms consider more detailed financial information from consumers' bank accounts — especially for “thin file” consumers who may lack extensive traditional credit histories — to evaluate their creditworthiness.

Using data with an obvious nexus to credit risk — and often data that have long been used but in a less structured way — can make good sense for lenders and borrowers. Better calibrated models can help creditors make better decisions at a lower cost, enabling them to expand responsible and fair credit access for consumers. Additionally, these models may decrease fair lending risk by ensuring that all applicants are evaluated by the same standards.

On the other hand, some data may lack an obvious nexus to creditworthiness. These data may be viewed as proxies or signals of potential creditworthiness or future income. Generally, the more speculative the nexus with creditworthiness, the higher the fair lending risk.²³ It is

easy to find examples of correlations between variables that are not meaningfully related.²⁴ Even if the data have some predictive foundation, to the extent the data are correlated with race or other prohibited bases under the fair lending laws, careful analysis is critical. For example, we understand that some lenders consider where an applicant went to school or an applicant's level of education. These data should be carefully evaluated for legal compliance before being used. This approach is reflected in the CFPB staff's recent no-action letter to a firm that considers educational data, in addition to traditional factors such as income and credit score, in underwriting and pricing loans. The CFPB recognized that the alternative data may benefit consumers who are credit invisible or lack sufficient credit history but conditioned the no-action letter on extensive fair lending testing and data reporting.²⁵

Careful analysis is particularly warranted when data may not only be correlated with race or national origin but may also closely reflect the effects of historical discrimination, such as redlining and segregation. For example, it's been reported that some lenders consider whether a consumer's online social network includes people with poor credit histories,²⁶ which can raise concerns about discrimination against those living in disadvantaged areas. Instead of expanding access

to responsible credit, the use of data correlated with race or national origin could serve to entrench or even worsen existing inequities in financial access. Finally, it is important to consider that some data may not appear correlated with race or national origin when used alone but may be highly correlated with prohibited characteristics when evaluated in conjunction with other fields.

Are the data accurate, reliable, and representative of all consumers?

Next, it is important to consider whether the data are accurate, reliable, and representative of a broad range of consumers. Inaccurate data can inappropriately penalize consumers and impair their access to credit. It also prevents banks from making loans available to creditworthy borrowers. In recent years, for example, concerns have been raised about the accuracy and reliability of medical debt data. Federal Reserve and FTC studies have found widespread errors in public record data on consumers' credit reports, much of which related to medical debt.²⁷ Recent CFPB complaint data have underscored continuing concerns from consumers, including credit reports listing medical debt that was already paid, was for the wrong amount, or was not properly verified.²⁸ As a result of concerns with these data, both FICO²⁹ and VantageScore³⁰ modified their scoring



models to limit the weight placed on these debts. These changes followed a series of 2015 agreements between the three largest consumer reporting agencies and the attorneys general of over 30 states.³¹

In addition to accuracy and reliability, it is important to consider whether the data are representative of all consumers or only a subset. Although the previous examples involving photo recognition and hiring may seem extreme, it is easy to see that many data sets may not be fully representative of the population for which the resulting model will be used. For example, data used for behavioral modeling — such as browsing and social media data — may be skewed toward certain populations.

While noting this risk, it is worthwhile to pause and emphasize that new research on alternative data may in fact improve data availability and representation for the millions of consumers who are credit invisible.³² Lenders currently lack good tools to evaluate these consumers' creditworthiness. Alternative data may result in new data sources that are accurate, representative, and predictive.³³ Such data can increase access to credit for this population and permit lenders to more effectively evaluate their creditworthiness.

Will the predictive relationship be ephemeral or stable over time?

Finally, it is important to consider whether the predictive potential of the data is likely to be stable over time or ephemeral. For example, if a model uses online data from social media sites, such as Yelp or Facebook, what happens to the reliability of those data as consumers' online habits evolve?

How Are You Using the Data?

Are you using the data for the purpose for which they have been validated?

Are the data being used for marketing, fraud detection, underwriting, pricing, or debt collection? Validating a data field for one use — such as fraud detection — does not mean it is also appropriate for another use, such as underwriting or pricing. Thus, it is important to ask if the data have been validated and tested for the specific uses. Fair lending risk can arise in many aspects of a credit transaction. Depending on how the data are used, relevant fair lending risks could include steering, underwriting, pricing, or redlining.

Do consumers know how you are using the data?

Although consumers generally understand how their financial behavior affects their traditional credit scores, alternative credit scoring methods could raise questions of fairness and transparency. ECOA, as implemented by Regulation B,³⁴ and the Fair Credit Reporting Act (FCRA)³⁵ require that consumers who are denied credit must be provided with adverse action notices specifying the top factors used



to make that decision. The FCRA and its implementing regulations also require that consumers receive risk-based pricing notices if they are provided credit on worse terms than others.³⁶ These notices help consumers understand how to improve their credit standing. However, consumers and even lenders may not know what specific information is used by certain alternative credit scoring systems, how the data impact consumers' scores, and what steps consumers might take to improve their alternative scores. It is, therefore, important that fintech firms, and any banks with which they partner, ensure that the information conveyed in adverse action notices and risk-based pricing notices complies with the legal requirements for these notices.

Certain behavioral data may raise particular concerns about fairness and transparency. For example, in *FTC v. CompuCredit*, mentioned earlier, the FTC alleged that the lender failed to disclose to consumers that their credit limits could be reduced based on a behavioral scoring model.³⁷ The model penalized consumers for using their cards for certain types of transactions, such as paying for marriage counseling, therapy, or tire-repair services. Similarly, commenters reported to the FTC that some credit card companies have lowered consumers' credit limits based on the analysis of the payment history of other consumers that had shopped at the same stores.³⁸ In addition to UDAP concerns, penalizing consumers based on shopping behavior may negatively affect a lender's reputation with consumers.

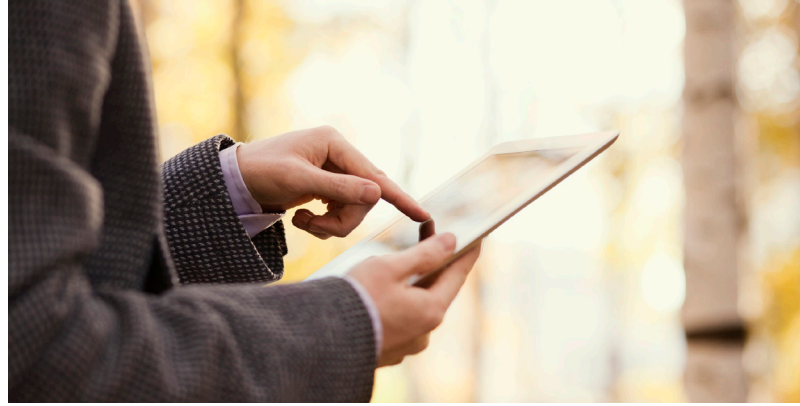
UDAP issues could also arise if a firm misrepresents how consumer data will be used. In a recent FTC action, the FTC alleged that websites asked consumers for personal information under the pretense that the data would be used to match the consumers with lenders offering the best

terms.³⁹ Instead, the FTC claimed that the firm simply sold the consumers' data.

Are you using data about consumers to determine what content they are shown?

Technology can make it easier to use data to target marketing and advertising to consumers most likely to be interested in specific products, but doing so may amplify redlining and steering risks. On the one hand, the ability to use data for marketing and advertising may make it much easier and less expensive to reach consumers, including those who may be currently underserved. On the other hand, it could amplify the risk of steering or digital redlining by enabling fintech firms to curate information for consumers based on detailed data about them, including habits, preferences, financial patterns, and where they live. Thus, without thoughtful monitoring, technology could result in minority consumers or consumers in minority neighborhoods being presented with different information and potentially even different offers of credit than other consumers. For example, a DOJ and CFPB enforcement action involved a lender that excluded consumers with a Spanish-language preference from certain credit card promotions, even if the consumer met the promotion's qualifications.⁴⁰ Several fintech and big data reports have highlighted these risks. Some relate directly to credit, and others illustrate the broader risks of discrimination through big data.

- It was recently revealed that Facebook categorizes its users by, among many other factors, racial affinities. A news organization was able to purchase an ad about housing and exclude minority racial affinities from its audience.⁴¹ This type of racial exclusion from housing advertisements violates the Fair Housing Act.⁴²
- A newspaper reported that a bank used predictive analytics to determine which credit card offer to show consumers who visited its site: a card for those with "average" credit or a card for those with better credit.⁴³ The concern here is that a consumer might be shown a subprime product based on behavioral analytics, even though the consumer could qualify for a prime product.
- In another instance, a media investigation showed that consumers were being offered different online prices on merchandise depending on where they lived. The pricing algorithm appeared to be correlated with distance from a rival store's physical location, but the result was that consumers in areas with lower average incomes saw higher prices for the same products than consumers in areas with higher average incomes.⁴⁴ Similarly, another media investigation found that a leading SAT prep course's geographic pricing scheme meant that Asian Americans were almost twice as likely to be offered a higher price than non-Asian Americans.⁴⁵
- A study at Northeastern University found that both digital steering and digital price discrimination were occurring at nine of 16 retailers. That meant that



different users saw either a different set of products as a result of the same search or received different prices on the same products. For some travel products, the differences could translate to hundreds of dollars.⁴⁶

The core concern is that, rather than increasing access to credit, these sophisticated marketing efforts could exacerbate existing inequities in access to financial services. Thus, these efforts should be carefully reviewed. Some well-established best practices to mitigate steering risk could help. For example, lenders can ensure that when a consumer applies for credit, he or she is offered the best terms she qualifies for, regardless of the marketing channel used.

Which consumers are evaluated with the data?

Are algorithms using nontraditional data applied to all consumers or only those who lack conventional credit histories? Alternative data fields may offer the potential to expand access to credit to traditionally underserved consumers, but it is possible that some consumers could be negatively impacted. For example, some consumer advocates have expressed concern that the use of utility payment data could unfairly penalize low-income consumers and undermine state consumer protections.⁴⁷ Particularly in cold weather states, some low-income consumers may fall behind on their utility bills in winter months when costs are highest but catch up during lower-costs months.

Applying alternative algorithms only to those consumers who would otherwise be denied based on traditional criteria could help ensure that the algorithms expand access to credit. While such "second chance" algorithms still must comply with fair lending and other laws, they may raise fewer concerns about unfairly penalizing consumers than algorithms that are applied to all applicants. FICO uses this approach in its FICO XD score that relies on data from sources other than the three largest credit bureaus. This alternative score is applied only to consumers who do not have enough information in their credit files to generate a traditional FICO score to provide a second chance for access to credit.⁴⁸

Finally, the approach of applying alternative algorithms only to consumers who would otherwise be denied credit may receive positive consideration under the Community Reinvestment Act (CRA). Recent interagency CRA guidance includes the use of alternative credit histories as an example of an innovative or flexible lending practice. Specifically, the

guidance addresses using alternative credit histories, such as utility or rent payments, to evaluate low- or moderate-income individuals who would otherwise be denied credit under the institution's traditional underwriting standards because of the lack of conventional credit histories.⁴⁹

ENSURING THAT FINTECH PROMOTES A FAIR AND TRANSPARENT MARKETPLACE

Fintech can bring great benefits to consumers, including convenience and speed. It also may expand responsible and fair access to credit. Yet, fintech is not immune to the consumer protection risks that exist in brick-and-mortar

financial services and could potentially amplify certain risks such as redlining and steering. While fast-paced innovation and experimentation may be standard operating procedure in the tech world, when it comes to consumer financial services, the stakes are high for the long-term financial health of consumers.

Thus, it is up to all of us — regulators, enforcement agencies, industry, and advocates — to ensure that fintech trends and products promote a fair and transparent financial marketplace and that the potential fintech benefits are realized and shared by as many consumers as possible. ■

ENDNOTES

¹The author gratefully acknowledges the research assistance of Katrina Blodgett.

²Kenneth P. Brevoort et al., "Data Point: Credit Invisibles," CFPB Office of Research at 12 (May 2015), http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf.

³There are many important consumer protection topics that are outside the scope of this article, including the Fair Credit Reporting Act and data security. For general information on these issues, see Federal Trade Commission, "Big Data: A Tool for Inclusion or Exclusion?" (January 2016), <https://www.ftc.gov/system/files/documents/reports/big-data-tool-inclusion-or-exclusion-understanding-issues/160106big-data-rpt.pdf>. For example, as noted on page 22 of this report, failure to reasonably secure consumers' data could be considered an unfair practice under the Federal Trade Commission Act.

⁴See *United States v. SunTrust Mortgage, Inc.*, No. 3:12-cv-00397-REP (E.D. Va., Consent order filed September 14, 2012); *United States v. Countrywide Home Loans, Inc.*, No. 11-cv-10540 (PSG) (C.D. Cal., Consent order filed December 28, 2011); *United States v. PrimeLending*, No. 3:10-cv-02494-P (N.D. Tex., Consent order filed January 11, 2011). For a discussion about the risks of discretion in pricing, see Outlook Live 2015 Interagency Fair Lending Hot Topics (October 15, 2015), <https://consumercomplianceoutlook.org/outlook-live/2015/interagency-fair-lending-hot-topics/>; Outlook Live 2013 Interagency Fair Lending Hot Topics (October 24, 2013), <https://consumercomplianceoutlook.org/outlook-live/2013/interagency-lending-hot-topics/>.

⁵The Supreme Court recently affirmed the availability of a disparate impact theory under the Fair Housing Act in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 135 S.Ct. 2507 (2015). It ruled that the Fair Housing Act permits liability under a disparate impact theory, and the act prohibits policies that seem to be neutral on their face but have a disparate impact on a protected class.

⁶Regulation B, 12 C.F.R. Part 1002, Comment 1002.6(a)-2; CFPB Bulletin 2012-04 (Fair Lending) (April 18, 2014), http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf.

⁷"Interagency Policy Statement on Discrimination in Lending," 59 FR 18266, 18269 (April 15, 1994), The CFPB adopted the Policy Statement in 2012. CFPB, Bulletin 2012-04 at 2-3 (April 18, 2012), http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf.

⁸See *United States & CFPB v. Provident Funding Assocs., LP*, No. 3:15-cv-02373 (N.D. Cal., Consent order filed May 28, 2015), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-and-department-of-justice-take-action-against-provident-funding-associates-for-discriminatory-mortgage-pricing/>.

⁹15 U.S.C. §45(a)(1)

¹⁰Pub. L. 111-203, title X, § 1031 (July 21, 2010), codified at 12 U.S.C. § 5331

¹¹Board of Governors of the Federal Reserve System, Federal Reserve Board Announces Civil Money Penalty and Issues Cease and Desist Order Against Higher One, Inc., (December 23, 2015), <https://www.federalreserve.gov/newsevents/pressreleases/enforcement20151223a.htm>.

¹²*FTC v. CompuCredit Corp.*, No. 1:08-CV-1976-BBM-RGV (N.D. Ga. 2008),

<https://www.ftc.gov/enforcement/cases-roceedings/062-3212/compucredit-corporation-jefferson-capital-systems-llc>; In re: CompuCredit Corp., Columbus Bank & Trust Co., First Bank of Delaware, First Bank & Trust, FDIC-08-139b (December 19, 2008), <https://www.fdic.gov/news/news/press/2008/pr08142.html>.

¹³*FTC v. Sequoia One*, Case No. 2:15-cv-01512 (D. Nev. 2015), <https://www.ftc.gov/enforcement/cases-proceedings/132-3253-x150055/sequoia-one-llc>.

¹⁴Executive Office of the President, "Big Data: Seizing Opportunities, Preserving Values" (May 2014), https://obamawhitehouse.archives.gov/sites/default/files/docs/big_data_privacy_report_may_1_2014.pdf; Federal Trade Commission, "Big Data: A Tool for Inclusion or Exclusion?" (January 2016), <https://www.ftc.gov/system/files/documents/reports/big-data-tool-inclusion-or-exclusion-understanding-issues/160106big-data-rpt.pdf>.

¹⁵See, e.g., Kate Crawford, "Artificial Intelligence's White Guy Problem," *New York Times* (June 26, 2016), <https://www.nytimes.com/2016/06/26/opinion/sunday/artificial-intelligences-white-guy-problem.html?mcubz=1>.

¹⁶Alexandra Chouldekova, "Fair Prediction with Disparate Impact: A Study of Bias in Recidivism Prediction Instruments," (Updated February 2017), <https://arxiv.org/pdf/1703.00056.pdf>; Julia Angwin et al., "Machine Bias," ProPublica, (May 23, 2016), <https://www.propublica.org/article/machine-bias-risk-assessments-in-criminal-sentencing>. See also Kate Crawford, "Artificial Intelligence's White Guy Problem," *New York Times* (June 26, 2016), <https://www.nytimes.com/2016/06/26/opinion/sunday/artificial-intelligences-white-guy-problem.html?mcubz=1>.

¹⁷Amit Datta, Michael Carl Tschantz, and Anupam Datta, "Automated Experiments on Ad Privacy Settings," *Proceedings on Privacy Enhancing Technologies* 2015, <https://www.degruyter.com/downloadpdf/j/popets.2015.1.issue-1/popets-2015-0007/popets-2015-0007.pdf>; Kate Crawford, "Artificial Intelligence's White Guy Problem," *New York Times* (June 26, 2016), <https://www.nytimes.com/2016/06/26/opinion/sunday/artificial-intelligences-white-guy-problem.html?mcubz=1>.

¹⁸David Ingold and Spencer Soper, "Amazon Doesn't Consider the Race of Its Customers. Should It?" *Bloomberg* (April 21, 2016), <https://www.bloomberg.com/graphics/2016-amazon-same-day/>; Kate Crawford, "Artificial Intelligence's White Guy Problem," *New York Times* (June 26, 2016), <https://www.nytimes.com/2016/06/26/opinion/sunday/artificial-intelligences-white-guy-problem.html?mcubz=1>.

¹⁹Kate Crawford, "Artificial Intelligence's White Guy Problem," *New York Times* (June 26, 2016), <https://www.nytimes.com/2016/06/26/opinion/sunday/artificial-intelligences-white-guy-problem.html?mcubz=1>. See also Steven Gaines and Sara Williams, "The Perpetual Line-up: Unregulated Police Face Recognition in America," *Georgetown Law Center on Privacy & Technology* (October 18, 2016), <https://www.perpetuallineup.org/>, last visited October 19, 2017.

²⁰NPR, "Weapons of Math Destruction Outlines Dangers of Relying on Data Analytics," (September 12, 2016), www.npr.org/2016/09/12/493654950/weapons-of-math-destruction-outlines-dangers-of-relying-on-data-analytics.

²¹ Michael Erman, “Automated Lenders Threaten to Eat Banks’ Lunch,” Reuters (June 11, 2015), <https://www.reuters.com/article/us-usa-banks-automation-insight/automated-lenders-threaten-to-eat-banks-lunch-idUSKBN0OR0BC20150611>.

²² Although social media data may be considered nontraditional data for consumer lending, assessing a firm’s online presence, including visibility and reviews, may be viewed as a logical extension of data used in the manual underwriting of small business loans.

²³ Cf. 1994 Policy Statement 59 Fed. Reg. at 18269; OCC Bulletin 97-24, Credit Scoring Models, Appendix at 1-2, 10-11 (May 20, 1997), <https://www.occ.treas.gov/news-issuances/bulletins/1997/bulletin-1997-24a.pdf>.

²⁴ See, e.g., Tyler Vigen, “Spurious Correlations,” <http://tylervigen.com/spurious-correlations>, last visited October 19, 2017.

²⁵ The no-action letter states that the CFPB does not currently plan to bring a supervisory or enforcement action against Upstart with respect to ECOA. The firm’s application describes its underwriting model, which considers educational attainment in addition to traditional credit factors, particularly for consumers with little credit history. CFPB staff specified that the no-action letter was issued based on the facts and circumstances of the applicant, and that the no-action letter does not endorse the use of any particular credit variables or credit modeling. CFPB staff conditioned the no-action letter on the firm regularly reporting lending and compliance information to the CFPB to mitigate risk to consumers and to assist the Bureau in understanding the impact of alternative data on lending. CFPB, “CFPB Announces First No-Action Letter to Upstart Network” (September 14, 2017), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-first-no-action-letter-upstart-network/>.

²⁶ Matt Vasilogambros, “Will Your Facebook Friends Make You a Credit Risk?” *The Atlantic* (August 7, 2015), <https://www.theatlantic.com/politics/archive/2015/08/will-your-facebook-friends-make-you-a-credit-risk/432504/>.

²⁷ Robert B. Avery et al., “An Overview of Consumer Data and Credit Reporting,” Federal Reserve Bulletin at 68, 71 (February 2003), <https://www.federalreserve.gov/pubs/bulletin/2003/0203lead.pdf> (noting that there may be errors and inconsistencies in public record reporting, including medical collections lawsuits, for several reasons: Many individuals have multiple public record items that appear to be part of a single episode, there are inconsistencies in public record reporting among geographic areas, and lack of data regarding the type of plaintiff in a public record action, such as a collector of medical debt); id. at 69 (finding that about 52 percent of collection accounts are based on medical debt); Federal Trade Commission “Report to Congress Under Section 319 of the Fair and Accurate Credit Transactions Act of 2003” (Accuracy Study) 50-51 (December 2012), at <https://www.ftc.gov/sites/default/files/documents/reports/section-319-fair-and-accurate-credit-transactions-act-2003-fifth-interim-federal-trade-commission/130211factareport.pdf> (finding 44 potential and 25 corrected errors relating to public records out of 1,001 study participants); at 3, 50-51 (noting that collection accounts can include medical bills and finding 502 possible errors relating to collection accounts with 267 corrected out of a sample of 1,001 consumers).

²⁸ Illustrating the potential impact of errors, a 2014 CFPB report found that about 19.5 percent of consumers have medical collection tradelines on their consumer reports. Of consumers that have any collection tradelines on their reports, 22 percent have only a medical debt trade line, and 50 percent of those consumers have a credit history with no other major blemishes. CFPB, “Consumer Credit Reports: A Study of Medical and Non-medical Collections,” (December 2014), http://files.consumerfinance.gov/f/201412_cfpb_reports_consumer-credit-medical-and-non-medical-collections.pdf.

²⁹ FICO, Press Release, “FICO® Score 9 Now Available to Consumers at myFICO.com” (March 8, 2016), www.fico.com/en/newsroom/fico-score-9-now-available-to-consumers-at-myficocom-03-08-2016.

³⁰ VantageScore, “Introducing VantageScore 4.0,” <https://your.vantagescore.com/vs40-intro>, last visited October 19, 2017.

³¹ See <https://ag.ny.gov/pdfs/CRA%20Agreement%20Fully%20Executed%203.8.15.pdf> and <http://www.ohioattorneygeneral.gov/Files/Briefing-Room/News-Releases/Consumer-Protection/2015-05-20-CRAs-AVC.aspx>. Under these agreements, the consumer reporting agencies will not report medical debt that is less than 180 days from date of first delinquency. In addition, the agencies will remove medical collection accounts that are paid by insurance where the consumer had no responsibility. The settlement includes a host of other provisions, including stricter requirements in reporting the classification of the source of debt and enhancements to the consumer dispute process.

³² Kenneth P. Brevoort et al., “Data Point: Credit Invisibles,” CFPB Office of Research at 12 (May 2015), http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf.

³³ CFPB, “Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process,” (February 14, 2017), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-explores-impact-alternative-data-credit-access-consumers-who-are-credit-invisible/> (describing the CFPB’s request for information on the use of alternative data and alternative models in credit scoring).

³⁴ 12 C.F.R. §1002.9

³⁵ 15 U.S.C. §1681m

³⁶ 15 U.S.C. §1681m(h); 12 C.F.R. Part 1022, subpart H; 16 C.F.R. Part 640

³⁷ *FTC v. CompuCredit Corp.*, No. 1:08-CV-1976-BBM-RGV (N.D. Ga. 2008), Complaint at 34-35, 39, <https://www.ftc.gov/sites/default/files/documents/cases/2008/06/080610compucrditcmplt.pdf>.

³⁸ FTC, Big Data Report at 9; Ron Lieber, “American Express Kept a (Very) Watchful Eye on Charges,” *New York Times* (January 30, 2009), <http://www.nytimes.com/2009/01/31/your-money/credit-and-debit-cards/31money.html?hp=&mcubz=1> (describing letters sent to customers by American Express stating that it was reducing their credit line based on the businesses the user patronized).

³⁹ *FTC v. Blue Global, LLC*, No 2:17-CV-021177-ESW (D. Ariz. 2017), <https://www.ftc.gov/enforcement/cases-proceedings/152-3225/blue-global-christopher-kay>.

⁴⁰ CFPB, “CFPB Orders GE Capital to Pay \$225 Million in Consumer Relief for Deceptive and Discriminatory Credit Card Practices,” (June 19, 2014), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-ge-capital-to-pay-225-million-in-consumer-relief-for-deceptive-and-discriminatory-credit-card-practices/>; <https://www.justice.gov/opa/pr/justice-department-and-consumer-financial-protection-bureau-reach-169-million-settlement>. The promotions allowed credit card customers with delinquent accounts to settle their balances. See also *In re American Express Centurion Bank and American Express Bank*, FSB, File No. 2017-CFPB-0016 (Consent Order August 23, 2017), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-and-american-express-reach-resolution-address-discriminatory-card-terms-puerto-rico-and-us-territories/> (CFPB action against American Express alleging discrimination for offering credit and charge card terms that had higher interest rates, stricter credit cutoffs, or less debt forgiveness to consumers in Puerto Rico and other U.S. territories and some consumers with Spanish-language preferences).

⁴¹ Facebook does not have race as a data field on its users. Instead, it uses racial affinity determined by an algorithm. See Annalee Newitz, “Facebook’s Ad Platform Now Guesses at Your Race Based on Your Behavior,” *Ars Technica* (March 18, 2016), <https://arstechnica.com/information-technology/2016/03/facebook-ad-platform-now-guesses-at-your-race-based-on-your-behavior/>.

⁴² Julia Angwin and Terry Parris Jr., “Facebook Lets Advertisers Exclude Users by Race,” *ProPublica* (October 28, 2016), <https://www.propublica.org/article/facebook-lets-advertisers-exclude-users-by-race>.

⁴³ Emily Steele and Julia Angwin, “On the Web’s Cutting Edge, Anonymity in Name Only,” *Wall Street Journal* (August 4, 2010), www.wsj.com/articles/SB10001424052748703294904575385532109190198; Jennifer Valentino-Devries and Jeremy Singer-Vine, “Websites Vary Prices, Deals Based on Users’ Information,” *Wall Street Journal* (December 24, 2012), <https://www.wsj.com/articles/SB10001424127887323777204578189391813881534>.

⁴⁴ Jennifer Valentino-Devries and Jeremy Singer-Vine, “Websites Vary Prices, Deals Based on Users’ Information,” *Wall Street Journal* (December 24, 2012), <http://online.wsj.com/news/articles/SB10001424127887323777204578189391813881534>.

⁴⁵ Julia Angwin and Jeff Larson, “The Tiger Mom Tax: Asians Are Nearly Twice as Likely to Get a Higher Price from Princeton Review,” *ProPublica* (September 1, 2015), <https://www.propublica.org/article/asians-nearly-twice-as-likely-to-get-higher-price-from-princeton-review>.

⁴⁶ Aniko Hannak et al., “Measuring Price Discrimination and Steering on E-commerce Web Sites,” Association for Computing Machinery (2014), <http://www.ccs.neu.edu/home/cbw/static/pdf/imc151-hannak.pdf>.

⁴⁷ See, e.g., National Consumer Law Center, “Full Utility Credit Reporting: Risks to Low-Income Consumers” (July 2012), https://www.nclc.org/images/pdf/energy_utility_telecom/consumer_protection_and_regulatory_issues/ib_risks_of_full_utility_credit_reporting_july2012.pdf (discussing risks to consumers of utility credit reporting and high rates of delinquency for low-income households in cold weather states); Massachusetts Department of Energy and Environmental Affairs, “Help with Your Winter Utility Bill,” www.mass.gov/eea/grants-and-tech-assistance/guidance-technical-assistance/agencies-and-divisions/dpu/winter-heating.html, last visited October 19, 2017 (describing several options for low-income consumers, including protection from energy shut-off during winter and payment plans).

⁴⁸ FICO, FICO Score XD: Expanding Credit Opportunities www.fico.com/en/products/fico-score-xd, last visited October 19, 2017.

⁴⁹ Interagency Questions and Answers Regarding Community Reinvestment, 81 Fed. Reg. 48,506, 48538-39 (July 15, 2016), <https://www.gpo.gov/fdsys/pkg/FR-2016-07-25/pdf/2016-16693.pdf>.

SERVICEMEMBER FINANCIAL PROTECTION: AN OVERVIEW OF KEY FEDERAL LAWS AND REGULATIONS

BY LANETTE MEISTER, SENIOR SUPERVISORY CONSUMER FINANCIAL SERVICE ANALYST FOR SUPERVISORY POLICY AND OUTREACH; LORNA NEILL, SENIOR COUNSEL IN CONSUMER LAWS AND REGULATIONS; AMAL PATEL, SENIOR SUPERVISORY CONSUMER FINANCIAL SERVICE ANALYST FOR SUPERVISORY POLICY AND OUTREACH; AND VIVIAN WONG, SENIOR COUNSEL IN CONSUMER LAWS AND REGULATIONS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

High-cost credit and the resulting debt burden can have serious adverse consequences for members of the armed services and their families, according to the U.S. Department of Defense (DOD).

“Financial burdens can undermine military readiness, damage the morale of servicemembers and their families, and add to the cost of maintaining an effective all-volunteer military defense force.”¹ To highlight financial institutions’ compliance obligations for servicemembers, this article discusses key provisions of the following federal laws, regulations, and guidance:

- The Military Lending Act (MLA) and its implementing regulation;
- The Servicemembers Civil Relief Act (SCRA);
- Regulations concerning military allotments; and
- Interagency guidance regarding mortgage servicing practices for military homeowners with permanent change of station orders.

The article also reviews effective compliance management measures that financial institutions can adopt to ensure that appropriate financial protections are afforded to servicemember customers and their dependents.

MILITARY LENDING ACT AND SERVICEMEMBERS CIVIL RELIEF ACT: OVERVIEW

The federal statutory framework for protecting servicemembers for consumer financial products and services consists of the MLA and the SCRA. The information in this section discusses highlights of each law and clarifies significant differences between them.

Both the MLA and the SCRA focus on protecting the financial interests of servicemembers and their dependents but differ in their scope. The MLA provides protections to servicemembers and their dependents for *credit extended while the servicemember is serving on active duty*. In contrast, the SCRA protects servicemembers and their dependents with *obligations incurred prior to entry into active duty*.

THE MLA AND THE MLA REGULATION²

The MLA was enacted in 2006 with the goal of protecting active duty military personnel, including those in the active National Guard or Reserve, as well as their spouses and other dependents, engaged in consumer credit transactions.³ Notably, the MLA limits the cost of covered transactions, which are subject to a Military Annual Percentage Rate (MAPR) cap of 36 percent.

The DOD has rulewriting authority to implement the MLA and originally issued a final rule in 2007.⁴ This rule applied solely to three closed-end credit products: payday loans for no more than \$2,000 and with a term of 91 days or fewer, motor vehicle title loans with a term of 181 days or fewer, and tax refund anticipation loans.

In July 2015, the DOD amended the MLA regulations, considerably broadening the types of consumer credit products within the scope of its coverage.⁵ Explaining that “the narrowly defined parameters of the credit products regulated as ‘consumer credit’ under [the 2007 rule] do not effectively provide the protections intended to be afforded to Service members and their families under the MLA,” the DOD expanded the scope of the MLA regulation generally to apply to most types of credit covered under the Truth in Lending Act (TILA) and Regulation Z.⁶ However, consistent with the MLA statute, the 2015 final rule continues to exempt home-secured credit and loans to finance the purchase of motor vehicles and other consumer goods that are secured by the purchased item.⁷ Accordingly, under the 2015 final rule, most credit products within the scope of TILA and Regulation Z are subject to MLA protections, including credit cards, deposit advance products, overdraft lines of credit,⁸ and certain installment loans.

The 2015 final rule also modified the fees that must be included when calculating the MAPR,⁹ the optional safe harbor provisions for creditors to determine whether consumers are entitled to MLA protections,¹⁰ and the MLA disclosure requirements.¹¹

Consumer credit that was extended and consummated between October 1, 2007, and October 3, 2016, is subject to the 2007 regulation. The compliance date for the 2015 final rule was October 3, 2016, except for credit card accounts, for which the compliance date is October 3, 2017.¹² Aspects of the MLA regulation are discussed here in more detail.

COVERAGE

The protections in the MLA regulation apply to consumer credit extended to a covered borrower. As noted, the MLA regulation's definition of *consumer credit* was significantly broadened in 2015 and now aligns more closely with the definition of the same term in Regulation Z. Specifically, consumer credit is defined as "credit offered or extended to a covered borrower primarily for personal, family, or household purposes, and that is: (i) subject to a finance charge, or (ii) payable by a written agreement in more than four installments."¹³ Also, the MLA exempts home-secured credit and loans to finance the purchase of motor vehicles and other consumer goods that are secured by the purchased item.

A *covered borrower* is a *covered member* of the armed forces, or a dependent of a covered member, who becomes obligated on a consumer credit transaction or establishes an account for consumer credit.¹⁴ Under the MLA, covered members of the armed forces include members of the Army, Navy, Marine Corps, Air Force, or Coast Guard currently serving on active duty pursuant to Title 10, Title 14, or Title 32 of the U.S. Code under a call or order that does not specify a period of 30 days or fewer, or such a member serving on Active Guard and Reserve duty as that term is defined in 10 U.S.C. §101(d)(6).

If a consumer opens a credit card account when the consumer is not a covered borrower, the account is not covered under the MLA even if the consumer later becomes an active duty servicemember. If a consumer opens a credit account while a covered borrower but later ceases active duty, the account is no longer subject to the MLA.

Generally, a creditor under the MLA is a person engaged in the business of extending consumer credit.¹⁵ A creditor may use its own process to determine if a consumer is a covered borrower. However, the regulation provides creditors an optional safe harbor from liability in conclusively determining whether credit is offered or extended to a covered borrower by using either of the following methods:

- Verifying the status of a consumer by using information relating to that consumer, if any, obtained directly or indirectly from the DOD's database, located at <https://mla.dmdc.osd.mil/mla>; or
- Verifying the status of a consumer by using information contained in a consumer report obtained from a consumer reporting agency that compiles and maintains files on consumers on a nationwide basis, or a reseller of consumer reports.¹⁶



RESTRICTIONS

For covered consumer credit transactions, the MLA and its implementing regulation limit the amount a creditor may charge, including interest, certain fees, and charges imposed for credit insurance, debt cancellation and suspension, and other credit-related ancillary products sold in connection with the account or transaction. The total charge, as expressed through the MAPR,¹⁷ may not exceed 36 percent.¹⁸ The MAPR includes charges that are not included in the finance charge or the annual percentage rate (APR) disclosed under TILA.

For closed-end credit, the MAPR is calculated following the rules for calculating and disclosing the APR for credit transactions under Regulation Z based on the charges required to be included in the MAPR by the MLA regulation.¹⁹ For open-end credit, the MAPR generally is to be calculated following the rules for calculating the effective APR for a billing cycle in 12 C.F.R. §1026.14(c) and (d) of Regulation Z²⁰ (as if a creditor must comply with that section) based on the charges required to be included in the MAPR by the MLA regulation.²¹

For covered consumer credit transactions, the MLA and its implementing regulation limit the amount a creditor may charge ...

For consumer credit card accounts under an open-end credit plan (not home-secured), certain fees are not required to be included in the MAPR calculation, provided that the fee is both bona fide and reasonable in amount.²² In assessing whether a bona fide fee is reasonable, the fee must be compared with fees typically imposed by other creditors for the same or a substantially similar product or service.²³ For example, when assessing a bona fide cash advance fee, that fee must be compared with fees charged by other creditors for transactions in which consumers received extensions of credit in the form of cash or its equivalent. The MLA regulation also provides a safe harbor standard for determining a “reasonable” amount of a bona fide fee for a credit card account.²⁴ There is no exclusion for “bona fide fees” for accounts that are not credit card accounts.

The MLA imposes a number of additional limitations and conditions on consumer credit extended to covered borrowers. These pertain to: (1) rolling over, renewing, repaying,

refinancing, or consolidating consumer credit extended to the covered borrower by the same creditor; (2) dispute resolution processes; and (3) payment terms and conditions.²⁵

DISCLOSURES

Under the MLA, if a creditor extends consumer credit (including through the Internet) to a covered borrower, the creditor must provide the borrower with the following information before or at the time the borrower becomes obligated on the transaction or establishes an account for the consumer credit:

- A statement of the annualized MAPR applicable to the extension of consumer credit;
- Any disclosure required by Regulation Z; and
- A clear description of the payment obligation of the borrower, as applicable.²⁶

The statement of the MAPR and the clear description of the payment obligation must be provided in writing in a form the covered borrower can keep.²⁷ A creditor must also provide such required information orally.²⁸ A creditor may satisfy the requirement to provide oral disclosures if the creditor provides the following to the covered borrower: (1) the information in person, or (2) a toll-free telephone number that the covered borrower may call to hear the oral disclosures by telephone.²⁹

CONSEQUENCES OF NONCOMPLIANCE

Statutory amendments to the MLA in 2013 granted enforcement authority for the MLA’s requirements to the agencies specified in TILA. These agencies include the Board of Governors of the Federal Reserve System (the Board), the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the Federal Trade Commission, the National Credit Union Administration, and the Office of the Comptroller of the Currency.³⁰ In addition to the remedies generally available to the listed agencies, the MLA regulation provides that consumer credit contracts that violate the MLA are void from inception.³¹

As amended in 2013, the MLA regulation provides that any person who violates the statute or implementing regulation is civilly liable for:

1. Any actual damage sustained, not less than \$500 for each violation;
2. Appropriate punitive damages;
3. Appropriate equitable or declaratory relief;
4. Any other relief provided by law; and
5. Costs of the action, including reasonable attorney fees.³²

However, the regulations protect against civil liability if a creditor is able to demonstrate by a preponderance of evidence that an MLA violation was unintentional and resulted from a bona fide error.³³ Particularly in light of the negative attention

that improper treatment of servicemembers typically attracts, MLA noncompliance can also result in significant reputational harm for a creditor.

THE SERVICEMEMBERS CIVIL RELIEF ACT

The Servicemembers Civil Relief Act (SCRA) is designed to ease financial burdens on servicemembers during periods of military service. The SCRA is a stand-alone statute with no implementing regulation or commentary. Several federal financial institution supervisory agencies, including the Board, have authority to take administrative action to enforce the SCRA against the institutions they supervise. The U.S. Department of Justice has the authority to file a civil action in court to enforce the SCRA.³⁴

The SCRA provides protections for military servicemembers primarily as they enter active duty. Military service is defined under the SCRA as including:

- Full-time active duty members of the five military branches (Army, Navy, Air Force, Marine Corps, and Coast Guard);
- Reservists on federal active duty;
- Members of the National Guard on federal orders for a period of more than 30 days;
- Servicemembers absent from duty for a lawful cause or because of sickness, wounds, or leave;
- Commissioned officers in active service of the Public Health Service (PHS) or the National Oceanic and Atmospheric Administration (NOAA).

Financial institution staff can confirm the servicemember status of a customer by:

- Reviewing any orders received from the borrower; or
- Searching the DOD's Defense Manpower Data Center site at <https://scra.dmdc.osd.mil> with the appropriate certificate.

Key provisions of the SCRA include the following:

6 PERCENT INTEREST RATE REDUCTION

The SCRA limits the amount of interest that a creditor can charge a servicemember on a financial obligation that was created prior to the borrower's entry into military service. The SCRA limits this interest to no more than 6 percent per year and requires forgiveness of any interest in excess of that ceiling. The interest reduction must be in effect for the borrower's period of military service or, in the





case of mortgage loans, during the period of military service plus one year thereafter. Under the SCRA, the term interest is defined to include “service charges, renewal charges, fees, or any other charges (except bona fide insurance) with respect to an obligation or liability.”³⁵

To receive the 6 percent interest rate reduction, the servicemember must provide the creditor with a copy of military orders and a written notice requesting the reduction no later than 180 days after the date of the servicemember’s termination or release from military service.³⁶

Once the creditor has received the servicemember’s request to reduce the rate, the creditor must forgive interest greater than 6 percent per year for the applicable time period. Accordingly, if a borrower makes a timely rate reduction request one year after entering military service, the creditor must reduce the rate to 6 percent both retroactively for the prior year as well as prospectively. The creditor is also prohibited from accelerating the payment of principal in response to a properly made request for a 6 percent interest rate reduction.³⁷

The 6 percent interest rate reduction broadly applies to any obligation or liability and would include, among other credit types, mortgages; home equity loans; automobile, boat, and other vehicle loans; credit cards; and student loans.

FORECLOSURE PROTECTION

The SCRA prohibits creditors from selling, seizing, or foreclosing on a servicemember’s real or personal property secured by a mortgage, trust deed, or other security in the nature of a mortgage, without a court order.³⁸ This prohibition is effective during the period of

military service and up to 12 months after service. This protection applies only to a servicemember’s obligation on real or personal property that: (1) originated before the period of the servicemember’s military service and for which the servicemember is still obligated, and (2) is secured by a mortgage, trust deed, or other security in the nature of a mortgage.³⁹

In addition, if an action to enforce a mortgage or trust deed is filed during or within one year after the period of military service, under certain circumstances a court may delay enforcement or adjust the obligation.⁴⁰

Protection from repossession of personal property

During the period of a servicemember’s military service, creditors must obtain a court order before terminating the servicemember’s lease or installment purchase contract, or repossessing personal property leased or purchased through an installment contract, for any breach of the contract that occurred before or during military service.⁴¹ A court must delay contract termination and repossession proceedings upon a servicemember’s request “when the servicemember’s ability to comply with the contract is materially affected by military service.”⁴²

Servicemember’s right to terminate a lease for a residence or motor vehicle

Under the SCRA, servicemembers are able to terminate any lease of premises that the servicemember or his or her dependents occupy or intend to occupy for a residential, professional, business, agricultural, or similar purpose if the lease was either:

- Entered into before military service or
- Executed by a servicemember while in service who

then receives orders for a permanent change of station (PCS) or a deployment, or as an individual in support of a military operation, for a period of 90 days or more.⁴³

If a servicemember pays rent on a monthly basis, once he or she gives proper notice and a copy of his or her military orders, the lease will terminate 30 days after the next rent payment is due.

Additionally, a servicemember may terminate the lease of a motor vehicle for either personal or business use by the servicemember or his or her dependent where:

- The lease is executed by the servicemember before entering a period of military service of 180 days or more; or
- While in military service, the servicemember executes the lease and subsequently receives military orders for a PCS to a location outside the continental United States or from a location outside the continental United States to any other location, or for a deployment with a military unit for a period of 180 days or more.

When responding to a servicemember's legitimate request to terminate a lease, the lessor may not impose an early termination charge. However, the servicemember may be charged for any unpaid rent or lease amounts owed for the period before lease termination as well as any taxes, summonses, title, and registration fees, or other obligations and liabilities in accordance with the terms of the lease, including reasonable charges for excess wear, that are due and unpaid at the time of lease termination.⁴⁴

Assignment of life insurance protections

Under the SCRA, if a life insurance policy on the life of a servicemember is assigned before military service to secure the payment of a loan, the creditor is prohibited, during the period of military service and for one year thereafter, from exercising any right or option under the assignment of the policy without a court order.⁴⁵

Protection from eviction

A landlord must obtain a court order before evicting a servicemember or dependent during a period of military service from premises occupied or intended to be occupied as a primary residence if the monthly rent does not exceed \$3,584.99 (by statute, \$2,400 adjusted annually for inflation).⁴⁶

Protection of an exercise of rights under the SCRA

The SCRA protects servicemembers from creditors taking certain negative actions such as denying credit, changing the terms of existing credit, or refusing to grant credit on terms substantially similar to those requested, solely because the servicemember exercised his or her rights or requested protections under the SCRA.⁴⁷

MILITARY ALLOTMENTS

The military allotment system is a payment mechanism by which a servicemember can direct the deduction of payments from his or her paycheck before the salary is deposited in the servicemember's deposit account. There are two types of military allotments:

- Nondiscretionary (e.g., court-ordered child support payments, repayment of loans extended by a military relief society)
- Discretionary (e.g., voluntary payments to dependents or other relatives, mortgage or rent payments, payments to repay a loan from a loan or finance company)

Servicemembers are not authorized to have more than six discretionary allotments at any one time. Under rules adopted by the DOD, effective January 1, 2015, servicemembers are not authorized to start allotments for the purchase, lease, or rental of personal property.⁴⁸ Discretionary allotments for the purchase, lease, or rental of personal property that started before January 1, 2015, are grandfathered; amounts for such allotments may be changed but cannot be re-established once cancelled.⁴⁹

The MLA regulation also prohibits creditors, other than military welfare societies or service relief societies, from requiring repayment by allotment as a condition to extending certain consumer credit to servicemembers and their dependents.⁵⁰ Financial institutions should also be aware that the Consumer Financial Protection Bureau (CFPB) has pursued a number of enforcement actions alleging unfair, deceptive, or abusive acts or practices related to repayment by military allotment.⁵¹

EFFECTIVE COMPLIANCE MANAGEMENT PRACTICES TO PROTECT SERVICEMEMBER RIGHTS

Financial institutions should build effective compliance management systems to ensure that appropriate financial protections are provided to servicemember customers and their dependents.

SERVICEMEMBER PROTECTION POLICIES AND PROCEDURES

Financial institution management should consider maintaining written policies and procedures approved by the institution's board of directors that outline the steps for staff to follow when responding to requests for financial services from a servicemember or a servicemember's dependents, as applicable. The institution's policies would clearly state where a request is routed, who reviews it and authorizes benefits, and who communicates the decision to the borrower about the request. These procedures could either be stand-alone or incorporated into existing broader procedures.

Some examples of policies and procedures for management to consider regarding MLA and SCRA compliance are included here, although financial institutions should also consider developing policies and procedures addressing other servicemember protections, such as the PCS servicing guidance and military allotment rules. (See sidebar on page 17.)

Policies and procedures for MLA compliance

Regarding the MLA, financial institutions should have appropriate policies and procedures in place, for example: to identify covered borrowers; meet disclosure requirements; calculate the MAPR for closed-end, credit card, and other open-end credit products; and review consumer credit contracts to avoid prohibited terms.

Policies and procedures, for example, should indicate that employees are to provide covered borrowers with a statement of the MAPR, any disclosure required by Regulation Z, and a clear description of the payment obligation before or at the time that a borrower becomes obligated on a consumer credit transaction or establishes a consumer credit account. The procedures would also detail the written and oral methods by which the disclosures are to be delivered.

Financial institutions are also encouraged to establish appropriate policies and procedures to calculate the MAPR for closed-end and open-end credit products (including credit card accounts) so that the charges and fees that must be included and those that may be excluded are accounted for appropriately. Financial institutions would also do well to adopt change management policies and procedures to evaluate whether any contemplated new fees and charges would need to be included in MAPR calculations before these new fees or charges are imposed. Additionally, financial institutions should consider how their staffs may effectively monitor the MAPR in connection with open-end credit products and whether to waive fees or charges, either in whole or in part, to reduce the MAPR to 36 percent or below in a given billing cycle or alternatively not impose fees and charges in a billing cycle that are in excess of a 36 percent MAPR (even if permitted under the applicable credit agreement).

Other best practices may include developing an inventory of products and services offered to servicemembers and their dependents — and potentially developing products and services specifically intended for servicemembers and their dependents, taking into account MLA limitations and MAPR requirements.

Policies and procedures for SCRA compliance

When a servicemember submits a request for an interest rate reduction on any loan covered under the SCRA, for example, procedures would clearly state how employees are to reduce the interest rate on qualified loans. The procedures would include instructions on how to adjust the rate

retroactively to the first day of eligibility and how to code the loans to adjust the periodic payments appropriately.

Although not required, a financial institution may want to consider searching for and flagging any additional loans that may qualify for coverage once a servicemember requests an interest rate reduction under the SCRA. Even if the servicemember does not request relief on additional loans at that time, it could be more expeditious for the financial institution to address all loans at the same time.

Additionally, policies and procedures regarding collections, mortgage foreclosures, and repossession of motor vehicles and other personal property would ideally address servicemember protections. Before initiating a foreclosure on a home or repossession of a vehicle or other personal property, the financial institution should determine whether the property is owned by a servicemember. The institution's policies would provide its personnel with guidance on how to determine ownership.

Foreclosures and repossessions can be lengthy processes, so financial institutions are encouraged to determine whether a borrower qualifies as a protected servicemember several times during the process. For example, in addition to performing an initial determination before beginning a foreclosure, institutions should redetermine the military service status prior to finalizing the foreclosure or repossession. Further determinations may be warranted for more protracted proceedings.

EMPLOYEE TRAINING ADDRESSING SERVICEMEMBER PROTECTION

Financial institutions should provide regular training for all of their employees on servicemember protections. Personnel extending and servicing credit-related products and services should understand an institution's compliance obligations associated with servicemembers and their dependents and financial institution personnel's role in ensuring effective compliance.

For example, employee training should also encompass effective and consistent processes to identify servicemembers that are or possibly may be covered by MLA and SCRA rights and protections as well as those to whom military allotment restrictions apply.⁵²

INTERNAL REVIEWS TO MONITOR COMPLIANCE WITH SERVICEMEMBER PROTECTIONS

The financial institution's quality assurance and audit staff should conduct regular reviews of the institution's compliance with servicemember financial protection requirements. Internal review or audit findings that report any policy exceptions should be communicated to the institution's board of directors and senior management for tracking and correction.

PERMANENT CHANGE OF STATION GUIDANCE

Active duty military personnel make permanent change of station (PCS) moves approximately every two to four years.⁵³ A PCS is the official relocation of an active duty military service member — along with any family members living with him or her — to a different duty location, such as a military base. For military homeowners, PCS orders that are nonnegotiable and operate under short timelines present unique challenges. Despite these challenges, military homeowners with PCS orders remain responsible for honoring their financial obligations, including their mortgages.

In June 2012, the Board, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, National Credit Union Administration, and Office of the Comptroller of the Currency, issued guidance to address mortgage servicing practices that may pose risks to military homeowners with PCS orders. The guidance, “Interagency Guidance on Mortgage Servicing Practices Concerning Military Homeowners with Permanent Change of Station Orders” (Interagency PCS Guidance), discusses risks related to military homeowners who have informed their loan servicer that they have received PCS orders and who seek assistance with their mortgage loans.⁵⁴

The Interagency PCS Guidance discusses financial institution and mortgage servicer responses when a

servicemember provides notice of a PCS. To avoid potentially misleading or harming homeowners with PCS orders, mortgage servicers (including financial institutions acting as mortgage servicers) should:

- Provide homeowners with PCS orders with accurate, clear, and readily understandable information about available assistance options for which the homeowner may qualify based on the information known to the servicer;
- Ensure that employees do not request that the servicemember waive legal rights in order to receive assistance;
- Provide a reasonable means for homeowners with PCS orders to obtain information on the status of their request for assistance; and
- Communicate in a timely way the servicer’s decision regarding requests for assistance from homeowners with PCS orders and include an explanation of the reason for a denial, where required, to provide the homeowner an opportunity to address any deficiencies.

Mortgage servicers can support their efforts to follow this guidance by training employees about the options available for homeowners with PCS orders and adopting mortgage servicing policies and procedures that direct appropriate employee responses to servicemembers requesting assistance.

MANAGEMENT INFORMATION SYSTEMS AND REPORTING ON SERVICEMEMBER PROTECTIONS

The financial institution’s customer information system (CIS) can be one of its most effective tools to facilitate identification and monitoring of customers eligible for protections under the MLA and/or the SCRA. CIS records flagged as servicemember or servicemember dependent, along with duty status dates, can inform staff tracking and management reporting to ensure that accounts associated with those customers are afforded appropriate protections.

OVERSIGHT OF THIRD-PARTY SERVICER COMPLIANCE WITH SERVICEMEMBER PROTECTIONS

The financial institution’s service provider risk management program should encompass consideration of compliance with servicemember financial protections. The service provider risk management program can vary based on

the scope and nature of the institution’s outsourced activities. But the financial institution’s management should ensure that its service provider risk management program extends to any activities that provide financial services to servicemembers or their dependents, as applicable.

In evaluating a financial institution’s compliance management practices to confirm that it adequately addresses servicemember financial protections, the institution’s management should consider each of the previously mentioned elements of a compliance management system.

Notably, with the October 3, 2017, compliance date for new MLA rules applicable to credit card accounts, financial institutions would be well advised to leverage their existing compliance management system’s strengths while adapting MLA-specific policies and procedures, employee training, internal controls, and management information systems to comply with the amended MLA regulation.

Specific issues and questions should be raised with your primary regulator. ■

ENDNOTES

¹ U.S. Department of Defense. *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*. August 9, 2006, <http://download.militaryonesource.mil/12038/MOS/Reports/ReportonPredatoryLendingPractices.pdf>.

² This section is intended to highlight certain key provisions of the MLA and its implementing regulation; however, it is not intended to provide an exhaustive summary.

³ 10 U.S.C. §987

⁴ The MLA implementing regulation is found at 32 C.F.R. part 232.

⁵ 80 Fed. Reg. 43560 (July 22, 2015); the DOD has also published an interpretive rule providing additional background information regarding compliance with the amended regulation. 81 Fed. Reg. 58840 (August 26, 2016).

⁶ 79 Fed. Reg. 58602, 58610 (September 29, 2014); see also 15 U.S.C. §1601 et seq. (TILA) and 12 C.F.R. part 1026 (Regulation Z).

⁷ 32 C.F.R. §232.3(f)(2)

⁸ However, the DOD has indicated that “an *overdraft service* typically would not be covered as consumer credit because Regulation Z excludes from ‘finance charge’ any charge imposed by a creditor for credit extended to pay an item that overdraws an asset account and for which the borrower pays any fee or charge, unless the payment of such an item and the imposition of the fee or charge were previously agreed upon in writing.” (Emphasis added.) 80 Fed. Reg. 43560, 43580 (July 22, 2015). See also the first interpretative question and answer at 81 Fed. Reg. 58840 (August 26, 2016).

⁹ 32 C.F.R. §232.4(c)

¹⁰ 32 C.F.R. §232.5(b)

¹¹ 32 C.F.R. §232.6

¹² 32 C.F.R. §232.13

¹³ 32 C.F.R. §232.3(f)(1)

¹⁴ 32 C.F.R. §232.3(g)

¹⁵ 32 C.F.R. §232.3(i). The term *creditor* also includes an assignee of a person engaged in the business of extending consumer credit with respect to any consumer credit extended.

¹⁶ 32 C.F.R. §232.5(b)

¹⁷ The MAPR is calculated in accordance with 32 C.F.R. §232.4(c).

¹⁸ 32 C.F.R. §232.4(b)

¹⁹ 32 C.F.R. §232.4(c)(2)(i)

²⁰ Sections 1026.14(c) and (d) of Regulation Z provide for the methods of computing the APR under several scenarios, such as (1) when the finance charge is determined solely by applying one or more periodic rates; (2) when the finance charge during a billing cycle is or includes a fixed or other charge that is not due to application of a periodic rate, other than a charge with respect to a specific transaction; and (3) when the finance charge during a billing cycle is or includes a charge relating to a specific transaction during the billing cycle. 12 C.F.R. §1026.14.

²¹ 32 C.F.R. §232.4(c)(2)(ii)

²² 32 C.F.R. §232.4(d). The exclusion for bona fide fees does not apply to charges based on application of a periodic rate, credit insurance premiums, or to fees for credit-related ancillary products.

²³ 32 C.F.R. §232.4(d). The DOD has indicated: “The ‘reasonable’ condition for a bona fide fee should be applied flexibly so that, in general, creditors may continue to offer a wide range of credit card products that carry reasonable costs expressly tied to bona fide, specific products or services and which vary depending upon the servicemember’s own choices regarding the use of the card.” 80 Fed. Reg. 43560, 43573.

²⁴ 32 C.F.R. §232.4(d)(3)(iii)

²⁵ 32 C.F.R. §232.8

²⁶ 32 C.F.R. §232.6. The DOD noted that “[A] creditor who is an assignee is not required to provide [the statement of the MAPR and the clear description of the payment obligation] ... [h]owever, the disclosures required by Regulation Z ... would remain subject to Regulation Z. ...” 80 Fed. Reg. 43588 (July 22, 2015). Additionally, the DOD has explained that: “The MLA regulation’s general timing requirement does not override more specific disclosure timing provisions in Regulation Z. The requirement in § 232.6(a) that any disclosure required by

Regulation Z be provided only in accordance with the requirements of Regulation Z does not amount to a requirement that MLA-specific disclosures be separately provided to borrowers in advance of TILA disclosures. Thus, the disclosures required in § 232.6(a) may be provided at the time prescribed in Regulation Z.”

²⁷ 32 C.F.R. §232.6(d)(1)

²⁸ 32 C.F.R. §232.6(d)(2)

²⁹ 32 C.F.R. §232.6(d)(2) The DOD has explained: “Oral disclosures provided through a toll-free telephone system need only be available under § 232.6(d)(2) (ii)(B) for a duration of time reasonably necessary to allow a covered borrower to contact the creditor for the purpose of listening to the disclosure.” 81 Fed. Reg. 58840, 58844 (August 26, 2016).

³⁰ 32 C.F.R. §232.10

³¹ 32 C.F.R. §232.9(c)

³² 32 C.F.R. §232.9(e)(1)-(3)

³³ 32 C.F.R. §232.9(e)(4)

³⁴ 50 U.S.C. §4041

³⁵ 50 U.S.C. §3937

³⁶ 50 U.S.C. §3937(b)

³⁷ 50 U.S.C. §3937(a)(3)

³⁸ 50 U.S.C. §3953

³⁹ 50 U.S.C. §3953, 50 U.S.C. §3953(b)

⁴⁰ 50 U.S.C. §3953(b). See also 50 U.S.C. §3954 (regarding settlement of stayed cases related to personal property (either under a mortgage or purchase contract)).

⁴¹ 50 U.S.C. §3952

⁴² 50 U.S.C. §3952, 50 U.S.C. §3952(c)

⁴³ 50 U.S.C. §3955

⁴⁴ See 50 U.S.C. §3955. Creditors should also be aware of SCRA provisions regarding tax obligations, including 50 U.S.C. §§3991, 4001(d), and 4021.

⁴⁵ 50 U.S.C. §3957

⁴⁶ 50 U.S.C. §3951

⁴⁷ 50 U.S.C. §3919

⁴⁸ DOD Financial Management Regulation, Volume 7A, Chapter 42, Paragraph 420201

⁴⁹ DOD Financial Management Regulation, Volume 7A, Chapter 42, Paragraph 420201, Paragraph 420202

⁵⁰ 32 CFR §232.8(g)

⁵¹ See *In the Matter of U.S. Bank National Association*, Consent Order, 2013-CFPB-0003 (June 26, 2013) and *In the Matter of Dealers’ Financial Services, LLC*, Consent Order, 2013-CFPB-0004 (June 25, 2013) (CFPB alleged that U.S. Bank and Dealers Financial partnered to require servicemembers to repay subprime automobile loans by allotment and, among other things, failed to disclose fees, failed to properly disclose payment schedules, and misrepresented charges for add-on products); *Consumer Financial Protection Bureau et al. v. Freedom Stores, Inc. et al.*, Civ. Action No. 2:14-cv-643-AWA-TEM (E.D. Va.), Complaint (December 18, 2014) and Final Order (January 9, 2015) (CFPB, with the attorneys general of North Carolina and Virginia, alleged that a retailer and associated finance companies unlawfully double-dipped by taking payments via both a servicemember’s allotment and bank or other required back-up account in the same month, and otherwise engaged in unfair or abusive debt collection practices, such as including nonnegotiable clauses in loan agreements mandating that disputes be resolved in a distant venue inconvenient for servicemembers); and *In the Matter of Fort Knox National Company and Military Assistance Co., LLC*, Consent Order, 2015-CFPB-0008 (April 20, 2015) (CFPB alleged that military allotment processors failed to disclose fee amounts for residual balances in allotment accounts and the fact that fees were charged).

⁵² Neither the MLA nor SCRA requires any specific method for confirming the military service status of an individual.

⁵³ See Military.com, “A Financial Guide to PCS Moves,” www.military.com/money/pcs-ditty-move/easing-stress-of-moving.html.

⁵⁴ See CA 12-8, “Mortgage Servicing Practices Concerning Military Homeowners with Permanent Change of Station Orders” (June 21, 2012), <https://www.federalreserve.gov/supervisionreg/caletters/caltr1208.htm>.

REGULATORY CALENDAR

Effective Date	Implementing Regulation	Regulatory Change
4/1/18 (most provisions)	Reg. E	Final rule extending the effective date for the prepaid account rule to April 1, 2018
1/16/18 (most provisions)	12 C.F.R. Part 1041	Final rule regulating payday, vehicle title, and certain high-cost installment loans
1/1/18	Reg. X	Final rule making inflation adjustment to the higher-priced mortgage loans exemption threshold
1/1/18	Reg. Z	Final rule making inflation adjustment for dollar threshold for credit exempt from Regulation Z
1/1/18	Reg. B	Final rule amending Regulation B's government monitoring information requirements to facilitate compliance with new Home Mortgage Disclosure Act (HMDA) rules
1/1/18 (most provisions)	Reg. C	Final rule implementing Dodd–Frank Wall Street Reform and Consumer Protection Act changes to the HMDA
1/1/18 (most provisions)	Reg. C	Final rule making technical amendments to new HMDA final rule
10/19/17 (most provisions)	Reg. X	Interim final rule making technical amendment to mortgage servicing rules for early intervention notices
10/19/17 (most provisions)	Reg. Z and X	Final rule for amendments to certain mortgage servicing provisions
10/19/17 (most provisions)	Reg. X	Final rule making technical amendment to mortgage servicing requirements for borrowers in bankruptcy
10/10/17	Reg. Z	Final rule amending certain TILA/RESPA Integrated Disclosure requirements
*	Reg. C	Proposed policy guidance to modify loan-level HMDA data before disclosing the data set to the public

* Proposed rules do not have an effective date.

NEWS FROM WASHINGTON: REGULATORY UPDATES*

The Consumer Financial Protection Bureau (CFPB) proposes policy guidance regarding public disclosure of loan-level Home Mortgage Disclosure Act (HMDA) data. On September 20, 2017, the CFPB proposed policy guidance that describes modifications that the CFPB plans to apply to the loan-level HMDA data that financial institutions will report pursuant to Regulation C beginning on January 1, 2018, before the data are disclosed to the public.

The Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank Act) amended HMDA to require collection and reporting of new data points and authorized the CFPB to require additional information from covered institutions. In October 2015, the CFPB issued a final rule amending Regulation C that included new and modified data fields.

Federal and state agencies use HMDA data to support a variety of activities. For example, some supervisory agencies use HMDA data in conducting Community Reinvestment Act (CRA) evaluations and fair lending examinations. Moreover, HMDA data disclosure provides the public with information on the home mortgage lending activities of particular reporting entities and on the activity in their communities. This information is used by local, state, and federal officials to evaluate housing trends and issues and by community organizations to monitor institution lending patterns.

The CFPB has interpreted HMDA to require that public HMDA data be modified, as is currently also the case, when the release of the unmodified data creates risks to applicant and borrower privacy interests that are not justified by the benefits of such release to the public in light of HMDA's statutory purposes. Specifically, the CFPB has interpreted HMDA to require the application of a balancing test to determine whether and how HMDA data should be modified prior to disclosure to the public.

After the application of its balancing test, the CFPB indicates, in its proposed policy guidance, that in connection with HMDA data that will be publicly disclosed beginning in 2019, it plans to: publicly disclose certain data fields in their entirety, modify certain data fields for public disclosure by reducing the precision of the values reported, and exclude certain data fields from public disclosure. The CFPB has reported that the proposed guidance will be nonbinding in part to preserve flexibility to revise the

modifications to be applied to the public loan-level HMDA data to maintain a proper balancing of the privacy risks and the benefits of disclosure.

The 60-day public comment period for the proposed guidance ended on November 24, 2017. The proposed guidance is available at http://files.consumerfinance.gov/f/documents/201709_cfpb_hmda-disclosure-policy-guidance.pdf.

The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency propose to amend their CRA regulations to conform to the CFPB's HMDA amendments. On September 13, 2017, the three agencies issued a joint notice of proposed rulemaking to amend their respective CRA regulations to revise the CRA consumer loan and home mortgage loan definitions and the CRA public file content requirements, to maintain consistency with corresponding CFPB amendments to Regulation C that are effective on January 1, 2018. In addition, the proposal contains technical corrections and would remove obsolete references to the Neighborhood Stabilization Program.

The proposed amendments to the CRA regulations would become effective on January 1, 2018. The 30-day public comment period closed on October 20, 2017. The proposal is available at <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170913a1.pdf>.

The CFPB temporarily changes the HMDA collection and reporting threshold for open-end lines of credit. On September 13, 2017, the CFPB issued a final rule amending its October 2015 updates to Regulation C by increasing the HMDA threshold for collecting and reporting data about certain dwelling-secured open-end lines of credit — to include home equity lines of credit — for a period of two years (calendar years 2018 and 2019). As a result, financial institutions originating fewer than 500 open-end lines of credit in either of the preceding two years would not be required to begin collecting such data until January 1, 2020.

The CFPB did not make the threshold increase for open-end lines of credit permanent at this time. Absent further action, effective January 1, 2020, the open-end threshold will be restored to the 100 open-end lines of credit threshold established by the October 2015 updates to Regulation C, and creditors originating between 100 and 499 open-end lines of credit will need to begin collecting and reporting HMDA data on open-end lines of credit.

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



The September 2017 final rule also contains a number of clarifications, technical corrections, and minor changes to Regulation C.

The changes will be effective on January 1, 2018. The final rule is available at: <https://www.gpo.gov/fdsys/pkg/FR-2017-09-13/pdf/2017-18284.pdf>.

The CFPB announces its annual adjustments to various Regulation Z thresholds. On August 30, 2017, the CFPB announced the annual Regulation Z dollar threshold adjustments for certain credit transactions, based on the annual percentage change reflected in the Consumer Price Index in effect on June 1, 2017. Specifically, the final rule published in the *Federal Register* amended the official interpretations for Regulation Z and adjusted:

- The minimum interest charge disclosure thresholds and the safe harbor penalty fee thresholds under the Credit Card Accountability Responsibility and Disclosure Act
 - o The minimum interest charge disclosure thresholds for §§1026.6(b)(2)(iii) and 1026.60(b)(3) will remain unchanged at \$1.00 for calendar year 2018.
 - o The safe harbor penalty fee thresholds remain unchanged at \$27 for §1026.52(b)(1)(ii)(A) (comment 52(b)(1)(ii)-2) (first violation safe harbor penalty fee) and \$38 for §1026.52(b)(1)(ii)(B) (comment 52(b)(1)(ii)-2) (subsequent violation safe harbor penalty fee) for calendar year 2018.
- The high-cost mortgage thresholds under the Home Ownership and Equity Protection Act
 - o The points and fees total loan amount threshold trigger under § 1026.32(a)(1)(ii)(A) (comment 32(a)(1)(ii)-1) for calendar year 2018 is \$21,032.
 - o The adjusted points and fees dollar trigger under §1026.32(a)(1)(ii)(B) (comment 32(a)(1)(ii)-3) for calendar year 2018 is \$1,052.
- The ability to repay and qualified mortgage thresholds under the Dodd–Frank Act
 - o A covered transaction is not a qualified mortgage under §1026.43(e)(3) (comment 43(e)(3)(ii)-1) in calendar year 2018 if the transaction’s total points and fees exceed: 3 percent of the total loan amount for a loan amount greater than or equal to \$105,158; \$3,155 for a loan amount greater than or equal to \$63,095 but less than \$105,158; 5 percent

of the total loan amount for loans greater than or equal to \$21,032 but less than \$63,095; \$1,052 for a loan amount greater than or equal to \$13,145 but less than \$21,032; or 8 percent of the total loan amount for loans less than \$13,145.

The changes will be effective on January 1, 2018. The final rule is available at <https://www.gpo.gov/fdsys/pkg/FR-2017-08-30/pdf/2017-18003.pdf>.

The Federal Financial Institutions Examination Council (FFIEC) members issue new HMDA examiner transaction testing guidelines. The recently issued FFIEC HMDA Examiner Transaction Testing Guidelines include

sampling, verification, and resubmission procedures for use in connection with HMDA data collected beginning on January 1, 2018, pursuant to the CFPB’s amendments to Regulation C. The guidelines describe the process of validating the accuracy of such HMDA data and the circumstances in which examiners may direct institutions to correct and resubmit data.

As the CFPB explained in a related blog post on August 22, 2017, the guidelines:

- Eliminate the “file” error resubmission threshold under which a financial institution would be directed to correct and resubmit its entire HMDA Loan Application Register (HMDA LAR) if the total number of sample files with one or more errors equaled or exceeded a certain threshold,
- Establish, for the purpose of counting errors toward the data “field” error resubmission threshold, allowable tolerances for certain data fields, and
- Lower the field error resubmission threshold to 10 percent for financial institutions with HMDA LAR counts of 100 or less.

The Federal Reserve’s CA letter and the guidelines are available at <https://www.federalreserve.gov/supervisionreg/caletters/caltr1702.htm>. The CFPB’s blog post is available at <https://www.consumerfinance.gov/about-us/blog/heres-what-you-need-know-about-new-ffiec-hmda-examiner-transaction-testing-guidelines/>. ■

ON THE DOCKET: RECENT FEDERAL COURT OPINIONS*

FAIR CREDIT REPORTING ACT (FCRA)

Reporting an authorized user who is not liable for an account did not violate the FCRA. *Pedro v. Equifax, Inc.*, 868 F.3d 1275 (11th Cir. 2017). The plaintiff was an authorized user on her parents' credit card account. After their deaths in 2014, the account became delinquent. TransUnion and Equifax reported the delinquency on the plaintiff's credit report, with a notation that she was an authorized user. The plaintiff's class action lawsuit alleged that TransUnion and Equifax willfully violated Section 1681e of the FCRA, which requires consumer reporting agencies preparing consumer reports to "follow reasonable procedures to assure maximum possible accuracy." The plaintiff alleged that the credit bureaus' reporting was inaccurate because she was not actually liable on the account and that such reporting caused her credit score to drop 100 points.

The court determined that the plaintiff had standing to file a federal lawsuit because she alleged concrete and actual injury. The court considered the alleged drop in the plaintiff's credit score and her time spent trying to resolve the issue, and further compared the alleged harm caused by inaccurate reporting with a defamation claim. Nonetheless, the court affirmed the dismissal of the lawsuit, agreeing with the district court that the plaintiff did not establish that TransUnion willfully violated FCRA Section 1681e. To do so, the court stated that the plaintiff must show that TransUnion adopted a reading of the statute that is objectively unreasonable. The court held that TransUnion could have reasonably interpreted the statute to permit it to report technically accurate information (i.e., that the plaintiff was an authorized user). Although the court stated that the better reading of the FCRA would be to require information be both technically accurate and not misleading, it stated that it could not find the alternative interpretation objectively unreasonable.

REGULATION X — REAL ESTATE SETTLEMENT PRACTICES ACT

The Eleventh Circuit affirms the dismissal of a lawsuit against a servicer because the borrower failed to send a Qualified Written Request to a specified address. *Bivens v. Bank of America, N.A.*, 868 F.3d 915 (11th Cir. 2017). Regulation X requires servicers to acknowledge and respond within certain time frames to a borrower's written request for information (known as a Qualified Written Request, or QWR) relating to the servicing of a federally related mortgage loan. The regulation also permits the servicer to designate an address to which QWRs must be sent. When the borrower received a notice from Select Portfolio Servicing (SPS), Inc. in 2012 that it was the new servicer for his loan, he sent SPS a written request for specific information but failed to send it to the address SPS designated for such requests. In response, SPS provided the correct address and some, but not all, of the requested information in a timely fashion. The borrower's lawsuit alleged that SPS violated the QWR requirements by not providing the requested information in a timely fashion. The borrower also argued that SPS did not properly designate an address for QWRs because it (1) did not use that specific term, instead providing an address for "disputes and inquiries," and (2) performed duties other than responding to QWRs at that address. The Eleventh Circuit affirmed the dismissal of the lawsuit, finding that Regulation X permits servicers to specify an address for QWRs and only obligates servicers to respond to QWRs sent to that address. The court also found that SPS had properly designated an address for receiving QWRs, noting that borrowers might not understand the technical term *qualified written request* and that SPS used terminology that was reasonably designed to minimize confusion. The court cautioned, however, that if a servicer uses terminology other than QWR, it must use terms that are "clear to a reasonable borrower."

REGULATION Z — TRUTH IN LENDING ACT (TILA)

The Eighth Circuit rejects borrowers' attempt to extend right of rescission from three days to three years. *Keiran v. Home Capital, Inc.*, 858 F.3d 1127 (8th Cir. 2017). Borrowers who had defaulted on their December 2006 mortgage loan sent a notice to the creditor that they were exercising the right of rescission in October 2009 for failure to provide sufficient copies of required TILA disclosures. In ensuing litigation, the borrowers contended that, in addition to not receiving the required number of TILA disclosures, the disclosures contained material inaccuracies related to the finance charge, and the creditor did

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



not respond in a timely fashion or adequately to the notice of rescission. The district court granted summary judgment in favor of the creditor, and the Eighth Circuit affirmed the dismissal. First, the Eighth Circuit noted that the borrowers signed a form acknowledging receipt of the right of rescission, for which Section 1635(c) of TILA creates a rebuttable presumption that the borrower received the notice. The court held that conclusory affidavits denying receipt of the notice, which are not supported by details or other supporting evidence, are insufficient to rebut this presumption. Regarding the allegation concerning inaccurate TILA disclosures, the court held that because the borrowers did not raise such objections in earlier litigation, the allegations were waived. Finally, the court held that because there was no TILA disclosure violation, the borrowers had only a three-day window under 12 U.S.C. §1635(a) to rescind, rather than a three-year window.

SERVICEMEMBERS CIVIL RELIEF ACT (SCRA)

The Fourth Circuit addresses SCRA foreclosure protections for servicemembers who reenter active duty service. *Sibert v. Wells Fargo Bank, N.A.*, 863 F.3d 331 (4th Cir. 2017). In May 2008, the plaintiff, an active duty member of the U.S. Navy, financed the purchase of his home with a loan extended by Advance Mortgage and later sold to Wells Fargo Bank, N.A. After leaving the Navy in July 2008, the plaintiff defaulted on the loan. Wells Fargo sent the plaintiff a default notice a few months later and, in March 2009, initiated nonjudicial foreclosure proceedings. In April 2009, the plaintiff enlisted in the U.S. Army, and in May 2009, Wells Fargo sold the house at a foreclosure sale.

In 2014, the plaintiff sued Wells Fargo, claiming that the foreclosure was invalid for an alleged violation of §3953(c) of the SCRA. Section 3953(c) provides that a foreclosure “shall not be valid if made during, or within one year after, the period of the servicemember’s military service except ... upon a court order granted before such sale, foreclosure, or seizure with a return made and approved by the court.” Section 3953(c)’s protections apply to real or personal property owned by a servicemember secured by a mortgage, trust deed, or other security in the nature of a mortgage for loans “originated before the period of the servicemember’s military service.”

The plaintiff argued that §3953(c) applied and that, accordingly, the foreclosure was invalid because the loan was originated prior to his Army active duty military service. This was an issue of first impression for the district court because it involved more than one period of military service: The plaintiff was in the Navy when the loan was originated, had left military service when foreclosure proceedings were initiated, and then later enlisted in the Army, during which his second period of active duty military service the foreclosure sale took place.

The district court granted Wells Fargo’s motion for summary judgment, explaining that “the statute does not apply to obligations incurred while one is in the military, because the underlying concern is the impact military service may have on a servicemember’s income and status, unanticipated at the time when they incurred the obligation.”

In the appeal, a divided panel of the Fourth Circuit affirmed the district court’s decision, the majority agreeing with the lower court’s interpretation of §3953(a). The appeals court stated: “Section 3953(a) explicitly creates two classes of obligations — those protected and those not. It provides protection to only those obligations that originate before the servicemember enters the military service. It thus grants protection to obligations incurred outside of military service, while denying protection to obligations originating during the servicemember’s military service. In this case, [the plaintiff’s] obligation originated while he was in the Navy and therefore was not in the class of obligations protected by the statute.”

The court rejected the plaintiff’s argument that, although the loan was extended when he was already on Navy active duty service, he nevertheless was entitled to “retroactive protection” when he entered Army active duty service because he became obligated on the loan before he joined the Army. The court found that such an interpretation of the statute would allow a servicemember to circumvent §3953(a)’s requirement that only loans originated before active duty military service qualify for §3953(c)’s protections simply by leaving the military and then reenlisting.

One member of the three-judge panel dissented, accepting the plaintiff’s argument that because the loan was originated before his Army active duty service the statute’s protections ought to apply; additionally, that judge argued that any statutory ambiguities should be resolved in favor of the servicemember. ■

WOULD YOU LIKE TO SUBSCRIBE TO *CONSUMER COMPLIANCE OUTLOOK* AND OUTLOOK LIVE?

Outlook and Outlook Live are both Federal Reserve System outreach platforms provided at no charge. *Outlook* is a newsletter published several times a year on federal consumer compliance topics, while Outlook Live is a webinar series on consumer compliance topics.

To subscribe to *Outlook* and Outlook Live, please visit consumercomplianceoutlook.org. There, you can choose to receive future editions of *Outlook* in electronic or print format. If you provide your e-mail address while subscribing, we will also notify you by e-mail of upcoming Outlook Live webinars.

CALENDAR OF EVENTS 2018

- | | |
|-----------------------|--|
| February 25–28 | ABA National Conference for Community Bankers
Hilton Hawaiian Village Waikiki Beach Resort, Honolulu, HI |
| March 10–16 | ABA Compliance School–Foundational
Grand Hyatt Denver, Denver, CO |
| April 4–6 | ABA Real Estate Lending Conference
JW Marriott, Indianapolis, IN |

Scan with your smartphone
or tablet to access *Consumer
Compliance Outlook* online.



consumercomplianceoutlook.org