

CONSUMER COMPLIANCE OUTLOOK®

A FEDERAL RESERVE SYSTEM PUBLICATION FOCUSING ON CONSUMER COMPLIANCE TOPICS

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UNDERSTANDING HOW CULTURE DRIVES A BANK'S MISSION*

BY ROBERT L. TRIPLETT III, SENIOR VICE PRESIDENT, BANKING SUPERVISION, FEDERAL RESERVE BANK OF DALLAS

As the officer in charge of banking supervision for the Federal Reserve Bank of Dallas, I need to be aware of banking conditions and challenges facing community banks in the Eleventh Federal Reserve District. I spend considerable time reaching out to community bankers, and they routinely talk about topics that are also at the top of my mind, including pressure on margins and earnings, regulatory burden, fintech's potential impact, succession management, and other issues. One topic that is not regularly mentioned — at least overtly — is corporate culture.

Although corporate culture may not come up directly in my discussions with bankers, it is nonetheless a critical component of a bank's operations that influences decisions and actions taken in response to the challenges and opportunities a bank faces. Recent enforcement actions, such as the penalties levied against Wells Fargo for its sales practices and the Environmental Protection Agency's consent decrees with Volkswagen for emissions testing violations, highlight the importance of culture in an organization. In both cases, evidence points to fundamental cultural issues that drove underlying behavior, resulting in undesired outcomes. Maintaining a strong, positive culture aligned with the organization's mission is critical for achieving long-term success and for avoiding missteps that can damage an organization's reputation or result in financial loss. As a bank supervisor, it is my view that aligning culture with mission is one of the most important areas of focus for a community bank.

What Is Culture?

A review of academic and business literature reveals no shortage of definitions of culture. The definitions vary and emphasize different aspects of culture, but a common theme across the definitions is the importance of an organization's values. An organization's values are often formed over time as its members encounter and resolve problems that arise from member interactions as well as operating in the business environment. The manner in which leadership responds to conflict often becomes the expected norm, and these norms are typically passed on to new members through immersion and teaching. Values are simply what is most important to the organization, and they define expectations for internal conduct and for interactions with customers and others outside the organization. Therefore, at its core, an organization's culture evolves from the set of values that guide decision-making and behavior.

**This article is also being published in Community Banking Connections (First Issue 2018), a Federal Reserve System publication focusing on safety and soundness topics.*

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FEDERAL RESERVE BANK OF PHILADELPHIA

UNDERSTANDING HOW CULTURE DRIVES A BANK'S MISSION

CONTINUED FROM PAGE 1

Decisions and the resulting actions often reflect a bank's culture. The prevailing culture in an organization may result from intentional thought and reinforcement, or it may simply reflect the aggregation of decisions and actions taken over time. Regardless, every organization will possess a distinct culture. Observed over time, the decisions made by an organization's leaders and the actions of its employees reveal its underlying values, which define the culture.

Why Is Culture Important?

Do not underestimate the importance of culture to a company's day-to-day functions. Employees are constantly evaluating how decisions are made, what is important to the leaders, and how they should respond and behave. Essentially, employees look for management to set the tone on how the company will operate. Do your employees understand how they should interact with customers? Have you clearly articulated the ethics and principles by which your bank will operate? Does the bank's senior management set the tone by demonstrating the strong, positive values that should be emulated by the bank's employees? Some of these questions will be answered explicitly through the bank's mission statement or other corporate declarations; however, follow-through by senior leadership is necessary for continued success. Because culture drives behavior, culture has significant implications for all critical aspects of a community bank's operations, including the way the bank will lend, how it will treat its customers, and the bank's role in the communities it serves.

Culture will evolve, especially as a bank faces new challenges. It is important that the bank's leaders often communicate the desired values and behaviors, such that the culture does not devolve into a conflicting set of norms or reflect an entirely different set of values. If guided by well-established values, decisions and actions that align with and reinforce established values will sustain the culture.

How Does a Bank Instill Culture?

To help ensure that a bank's culture aligns with its mission, core values should be thoughtfully considered and support the business objectives that allow the bank to fulfill its mission. Once established, the bank's core values should be communicated throughout the organization. A bank's culture should be instilled rather than imposed. Simple platitudes cannot produce a desired culture, especially if actions are inconsistent with the expressed cultural values. Instead, values should be consistently reinforced and demonstrated through senior leaders' actions.

Having regular dialogue within the bank about culture is important for establishing the bank's current core values and shaping future values. Most community bankers who I have met would broadly describe their bank's mission as fairly and profitably meeting the financial service needs of the communities they serve. To help achieve its mission, a bank may list providing superior customer service as one of its core values. However, front-line employees' experiences may reveal that the culture instead is driven by

the value of speed — handling the highest volume of transactions in the least amount of time — or in a way that generates the greatest profit. Thus, instead of consistently delivering superior customer service, employees may often do what is expedient during peak business hours, which could mean employees may not follow established procedures but take shortcuts instead.

Certainly, taking shortcuts can be detrimental to providing superior customer service. Depending on the nature of the transaction, failure to follow established procedures could expose the bank to financial loss. Further, at the extreme, this could result in mistreatment of customers and

A CEO must champion a strong, positive culture by showing up every day with a focus on demonstrating and reinforcing the bank's core values.

violations of consumer protection laws and regulations. For example, certain required disclosures might not be provided to consumers. Or, in the absence of following established procedures designed to promote equitable treatment, employee biases — overt or not — could drive less favorable treatment of customers on a prohibited basis.

In this instance, employee behavior would not be consistent with the bank's articulated core values. This example is not meant to suggest that superior customer service and efficiency are at odds; what it does mean is that it is insufficient to simply espouse a value and expect it to stick. Rather, a bank's core values must be supported by strong policies, procedures, training, and an incentive structure that is aligned with and reinforces those values. In my example, expectations for what constitutes superior customer service in the context of any particular job should be defined. Decisions about transaction volume goals and staffing during peak business hours should be realistic and established consistently with the customer service value in mind. Only then will the values, culture, and mission align.

How Is Culture Maintained?

Even if values have been effectively communicated and embedded in the bank's operations, the culture supported by these values must be reinforced. As I mentioned earlier, while values will drive behavior, culture ultimately is a reflection of actual behaviors, not desired behaviors.

Senior bank leaders need to clearly articulate and reinforce the bank's core values in their communications to employees, but doing this alone is not enough to maintain

a culture. If behaviors at odds with core values are allowed to persist, such communications will not matter. Senior leaders in the organization must exhibit behavior consistent with the bank's core values. In other words, they must "walk the talk." Additionally, behaviors throughout the organization that do not align with the culture must be identified and corrected. Often, such behaviors can be identified through established processes for evaluating management and employee performance. Correction may take the form of revising procedures that promote misaligned behavior, providing additional training to an employee, or, at the extreme, taking proportionate disciplinary action.

Open dialogue can be a powerful means for management and staff to speak about the bank's culture and how it contributes to meeting the bank's mission. Such dialogue can also be a means to identify barriers to values-driven behavior or examples of values-inconsistent behaviors. In some cases, it may be difficult for an employee to openly discuss concerns about behaviors he or she witnesses, especially if such behaviors cross ethical or legal boundaries. For that reason, banks should strongly consider making available to employees a means to voice such concerns anonymously, such as a hotline. In the end, organizations, including community banks, need multiple avenues to collect and identify information to aid in maintaining and improving corporate culture.

Conclusion

I would like to close with a message specifically to community bank chief executive officers (CEOs). Someone once told me, "Leaders cast long shadows." This person meant that employees look to their leaders for inspiration and direction, particularly when a potentially controversial or ethical decision must be made. Bank employees will observe how decisions or actions are handled by management and whether matters are handled in a way that is consistent with cultural norms.

Deviating from well-established norms or making decisions that erode the culture will chip away at a CEO's credibility as an individual and a leader. Much like the referees in a football game, employees are keeping a watchful eye on the CEO's performance. Employees may not literally throw a flag, but once the CEO commits a culture infraction, you can expect to be penalized, and it is tough to earn back their respect and trust.

To ensure the success of your team and fulfill your bank's mission, as its leader, a CEO must champion a strong, positive culture by showing up every day with a focus on demonstrating and reinforcing the bank's core values. I believe the deep, values-based connections formed among bank leaders, employees, and their customers are essential for the continued success of community banking. ■

RESPONDING TO COUNTERFEIT INSTRUMENT SCAMS

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

Editor's Note: This article was originally published in 2008. We have updated it to reflect changes that have occurred since then.

It has become an all-too-familiar situation for many financial institutions: A customer makes a transaction with a third party over the Internet (e.g., selling an item on an online marketplace) and is paid with a counterfeit cashier's check, money order, or similar instrument. The customer deposits it into his bank account, and the institution provisionally makes the funds available by the next business day, as required by the Expedited Funds Availability Act (EFAA) and Regulation CC, its implementing regulation. When the customer checks his balance and learns that his available balance includes the

In the 2011 [FTC] survey (the most recent), the total number of counterfeit check incidents was estimated to be between 100,000 and 1.1 million.

deposit, he completes the transaction with the third party by sending a wire payment to the buyer based on a contrived explanation:

I'm enclosing payment for the car you listed on eBay. The check is greater than your asking price because I hired a shipping agent to deliver it. The check includes the shipper's fee and an extra \$100 for your trouble. Please wire the overpayment, less your \$100, to the shipper.

The payor bank to which the check will be presented for payment will flag it as a counterfeit and return it to the depository bank, a process that can take several weeks.¹ When the check is returned unpaid, the depository bank will deduct the amount of the check from the customer's account or demand repayment if the account has insufficient funds. The customer had assumed the check was paid because the funds were labeled as available and blames the bank for this misunderstanding; however, the bank has simply complied with federal law by providing a provisional credit within the EFAA/Regulation CC timeframe.

The Federal Trade Commission (FTC) tracks incidents of counterfeit checks and other scams through a periodic survey. In the 2011 survey (the most recent), the total number of counterfeit check incidents was estimated to be between 100,000 and 1.1 million.² The Better Business Bureau also reports that counterfeit check scams ranked second on its list of the Top 5 Most Risky Scams for 2016.³ These data points suggest that counterfeit cashier's checks and similar instruments continue to present challenges for consumers and financial institutions. This article provides an overview of this issue and sound practices for financial institutions to help mitigate the risks.

Background

Congress passed the EFAA in 1987 to "end excessive holds on customer deposits by depository institutions"⁴ by establishing the maximum permissible hold periods for checks and other types of deposits. For certain "safe" instruments considered low risk for being dishonored, the law requires next business day availability. This includes cashier's and certified checks, Treasury checks, U.S. postal money orders, checks drawn on a Federal Reserve Bank or Federal Home Loan Bank, and checks issued by a state or local government.⁵

Although the law ended unreasonable hold periods, criminals have developed fraudulent schemes that exploit the delay between the time federal law requires funds to be made available from a deposit and the time a counterfeit instrument is returned by the institution on which the check is purportedly drawn.

When the EFAA was enacted, desktop publishing was in its infancy, and tools to create high-quality counterfeit checks were expensive and not readily available. Consequently, Congress did not consider the risk of counterfeit instruments when it mandated next-day availability for certain instruments.⁶

Desktop publishing has evolved considerably since 1987. Inexpensive, off-the-shelf software and hardware can now create counterfeit instruments, such as cashier's checks or money orders, that look identical to the actual ones.⁷ Criminals understand that many people mistakenly believe that these checks or money orders cannot be rejected, so they exploit the delay between the time deposits must be made available provisionally under the EFAA and the time it takes to discover an instrument is counterfeit. During this window of opportunity, fraudsters deceive victims into wiring excess funds from the check or money order that was deposited.

Nature of the Schemes

Although too many schemes exist to provide an exhaustive list, some of the common ones many institutions encounter include:

- **Online transactions:** As discussed previously, a consumer sells an item through an online marketplace such as eBay or Craigslist, and someone offers to buy it using a cashier's check (or similar instrument) for an amount greater than the asking price. The buyer offers a contrived explanation for the overpayment and asks the seller to deposit the check, keep the amount of the selling price plus \$100 extra for his time, and wire the balance back to the buyer after the check clears.
- **Mystery shopper:** The consumer receives a letter stating she has been chosen to act as a mystery shopper and receives a cashier's check to deposit. The consumer is told to use a portion of the funds to purchase merchandise at the designated stores, transfer a portion of the funds to a third party using a designated wire service company, and keep the remainder.⁸
- **Lottery or inheritance:** The consumer is notified that he won a lottery (even though the consumer may not have actually purchased a ticket) or inherited money, and he receives a check, with a request to wire back a portion of the check to cover taxes.

While these schemes initially focused on consumers, businesses — particularly law firms — also have been targeted in recent years. In a common scheme, the fraudsters contact law firms pretending to be new clients seeking representation to collect debts. For example, in *Greenberg, Trager & Herbst, LLP v. HSBC Bank USA*,⁹ a North Carolina law firm received an email from a company in Hong Kong that sought to retain the law firm to collect debts from its customers in North America. When the law firm asked for a retainer, the potential client said that one of its customers sent a payment to the law firm, from which the retainer could be deducted. The firm received a Citibank check for \$197,750, which the law firm deposited into its attorney trust account with HSBC. Processing of the check was delayed because it had an incorrect routing number, which criminals sometimes deliberately do to slow the discovery of the fraud.¹⁰

The law firm alleged that an HSBC representative confirmed by phone that the check had “cleared” and that the funds were available in the account. Based on this information, the firm wired \$187,750 to the new client in Hong Kong. Citibank later notified HSBC that the check was a counterfeit, and HSBC revoked the provisional credit for the deposit and deducted the amount from the firm's bank account. The law firm sued Citibank and HSBC, but the lawsuit was dismissed. On appeal, the New York Court

of Appeals affirmed the dismissal, noting that Citibank, as the payor bank, returned the item within the timeframe of the Uniform Commission Code's midnight deadline rule and that was the extent of its legal obligation to the law firm.¹¹

Many similar cases involving law firms have emerged in recent years involving counterfeit checks for hundreds of thousands of dollars.¹² Thus, counterfeit check schemes continue to present risks to consumers, businesses, and financial institutions.

Risk Mitigation

Educating Customers

Counterfeit instrument scams present challenges for financial institutions because many consumers and businesses believe that certain instruments, such as a cashier's check or a money order, cannot be dishonored. They therefore assume that provisional next-day funds availability means their financial institution was paid on the deposited instrument.

Financial institutions can play an important role by educating their customers about this issue. This is admittedly a delicate task because banks want to educate their customers without alarming them.

When a check or similar instrument subject to next-day availability of funds is deposited, a financial institution will typically provide a receipt indicating the date on which the funds will be available. This receipt provides an opportunity to communicate to customers that, although funds may be made available provisionally the next business day because of federal law, this availability does *not* mean the item has been paid by the issuing bank and customers should exercise caution when dealing with third parties with whom they have no prior relationship or experience.

For deposits made in person, banks could consider training tellers to discuss the risks of accepting cashier's checks from third parties with whom they have little or no prior dealings.

Banks might also ask tellers to provide to customers depositing items subject to next-day availability the FTC's brochure titled *Giving the Bounce to Counterfeit Check Scams*.¹³

The brochure provides helpful information that banks can share with their customers to help educate them, including the following tips:

- Avoid offers that require paying for a free prize or a gift.

- Know who you are dealing with and never wire money to strangers.
- When selling something, never accept payment for more than the selling price, no matter how tempting the offer or how convincing the story. Suggest an alternative way for the buyer to pay, such as an escrow service or online payment service.
- When accepting payment by check, ask that the check be drawn on a local bank or a bank with a local branch to verify the check is valid.
- If a buyer insists that you wire back funds, end the transaction. Legitimate buyers don't pressure you to send money by wire transfer services. In addition, you have little recourse if there's a problem with a wire transaction.
- Resist any pressure to "act now."

Other helpful tips for consumers include:

- Understand the difference between having access to funds from a deposit because federal law requires it and the actual time it can take for banks to clear checks.
- Examine cashier's checks or money orders carefully for any irregularities.
- Contact the banks issuing cashier's checks and money orders to verify if the instruments were issued in the amount stated and if they had been paid to the depository bank. Customers should obtain the bank's phone number from an independent source, since the counterfeit check could display a fake phone number of a person working in tandem with the fraudster.
- Be aware that wire transfers generally cannot be canceled once the transfer has been completed.
- Remember the adage: If it sounds too good to be true, it probably is.

Banks can also consider posting advisories on their websites, in their mobile applications, and in branches about counterfeit check scams to alert customers to the red flags of suspicious transactions.¹⁴

Educating Employees

A well-trained staff can also help detect counterfeit or altered checks. Some physical counterfeit signs that employees can be vigilant for include signs of alteration or erasing, spelling errors, mistakes, suspicious check amounts, a lack of or incorrect financial institution information, a routing number that does not match the

routing number of the instrument's issuer, and an incorrect sequence number.

A bank could also mitigate risks by including its wire department in any educational campaign because many schemes require the consumer or business to wire funds to a fraudster. Banks may consider training wire department staff to recognize suspicious transactions in which bank customers are at high risk for counterfeit check scams. Typically, these scams involve some or all of the following characteristics:

- A wire-transfer request made shortly after a check has been deposited is subject to next-day availability that a customer received from a third party with whom the customer has no prior dealings.
- The instrument deposited is generally believed by consumers to be incapable of bouncing such as a cashier's check or certified check.
- A customer who rarely makes wire transfers makes a transfer.
- A recipient is outside the United States.

When a wire transfer is requested with some or all of these characteristics, staff may consider informing the customer about counterfeit check scams and the risk of wiring funds to someone with whom the customer has no prior relationship.

Verifying Suspected Counterfeit Instruments

Financial institutions can also check online databases to verify if a Treasury check, postal money order, or Walmart money order was validly issued.

Treasury checks

The Treasury department has an online application to authenticate Treasury checks; banks can enter the amount of a Treasury check and its number to verify it was issued.¹⁵

The site also provides a guide to the security features of Treasury checks that can be used to detect counterfeits.

Postal money orders

The U.S. Postal Service provides a phone number to verify postal money orders: 866-459-7822. The postal service also has a web page discussing security features.¹⁶

Walmart money orders

Walmart money orders can be verified by calling 800-542-3590.

Conclusion

When the EFAA was enacted, counterfeit checks and other

instruments did not present a significant risk, and Congress required short hold periods for instruments with low rates of return. However, advances in technology have enabled individuals to create sophisticated counterfeit instruments inexpensively. The short hold periods under the EFAA for

certain instruments presents a challenge for consumers, businesses, and financial institutions. Educating customers and training employees can help mitigate the financial impact of these scams. Specific issues or questions should be discussed with your primary regulator. ■

ENDNOTES

¹ “Avoiding Cashier’s Check Fraud,” Comptroller of the Currency Consumer Advisory (January 6, 2007), available at <https://www.occ.gov/news-issuances/consumer-advisories/2007/consumer-advisory-2007-1.html>.

² The Federal Trade Commission (FTC) uses a sample size for the survey and then projects the results to the estimated U.S. population. The 2011 survey report is available at https://www.ftc.gov/sites/default/files/documents/reports/consumer-fraud-united-states-2011-third-ftc-survey/130419fraudsurvey_0.pdf. The number of incidents is greater than the number of victims because a consumer can be involved in more than one incident. The FTC also tracks the number and type of complaints it receives, including complaints for counterfeit cashier’s checks, in its annual *Consumer Sentinel* reports, which are available at <https://www.ftc.gov/enforcement/consumer-sentinel-network/reports>.

³ See <https://www.bbb.org/globalassets/local-bbbs/council-113/media/scam-tracker/risk-report/bbb-scamtracker-infographic-2.pdf>.

⁴ S. REP. No. 100-19, at 1 (1987)

⁵ 12 C.F.R. §229.10(c)

⁶ Congress heard testimony on the emergence of this problem in a 1997 hearing, “Computer Generated Check Fraud.” Hearing before the Subcommittee on Domestic and International Monetary Policy, the Committee on Banking and Financial Services, and the House of Representatives, May 1, 1997. “The technological improvements that have fueled the growth in check fraud schemes have made it difficult for law enforcement to combat the problem, *Forbes* magazine reported on the trend in 1989, stating “the desktop computer did not create the crime of forgery. All it did was make the tools user-friendly. With the prevalence of laser printers and advanced duplication systems, the production of quality counterfeit checks has improved substantially.” (Statement of Charles L. Owens), <https://archives.financialservices.house.gov/banking/5197chow.shtml>. See also “New Breed of Check Forgers Exploits Desktop Publishing,” Saul Hansell, *New York Times* (August 15, 1994). “The proliferation of desktop publishing has brought a new growth industry, the counterfeiting of virtually undetectable fraudulent checks, and banks and law enforcement officials say the cost to the economy could reach \$1 billion this year.” <https://www.nytimes.com/1994/08/15/us/new-breed-of-check-forgers-exploits-desktop-publishing.html>.

⁷ Brandon and Ohre, “The Nigerian Check Scam: An Oldie Revisited,” 126 *Bank. L.J.* 223, 224 (March 2009), available at www.squirepattonboggs.com/~media/files/insights/publications/2009/03/ithe-banking-law-journalithe-nigerian-check-sca_/files/the-nigerian-check-scam/fileattachment/the-nigerian-check-scam.pdf.

⁸ See <https://www.occ.gov/news-issuances/consumer-advisories/2007/consumer-advisory-2007-1.html>.

⁹ See 17 N.Y.3d 565, 958 NE2d 77 (N.Y. 2011) www.nycourts.gov/ctapps/Decisions/2011/Oct11/152opn11.pdf.

¹⁰ See <https://dbf.georgia.gov/check-fraud-counterfeit-checks>.

¹¹ Greenberg, 17 N.Y.3d at 577

¹² See, e.g., *Law Offices of Oliver Zhou v. Citibank N.A.*, 2016 WL 2889060 (S.D.N.Y. May 17, 2016); *Mechanics Bank v. Methven*, 2014 WL 4479741 (Court of Appeals 1st Dist. 2014); *Kevin Kerveng Tung, P.C. v. JPMorgan Chase & Co.*, 105 A.D.3d 709, 963 N.Y.S.2d 145 (2nd Dept. 2013); *Fifth Third Bank v. Hirsch*, 2011 WL 5403600 (N.D. Ill. November 8, 2011); *Branch Banking & Trust Co. v. Witmeyer*, 2011 WL 3297682 (E.D. Va. January 6, 2011). For additional information, see Todd Scott, “Scammed! Sophisticated Check Fraud Schemes Target Lawyers,” *Law Trends & News* (American Bar Association, Fall 2010), https://www.americanbar.org/newsletter/publications/law_trends_news_practice_area_e_newsletter_home/10_fall_pm_feat1.html.

¹³ See <https://www.ftc.gov/news-events/press-releases/2007/02/ftc-advice-giving-bounce-counterfeit-check-scams>.

¹⁴ The Georgia Department of Banking and Finance has a web page discussing red flags for counterfeit checks, available at <https://dbf.georgia.gov/check-fraud-counterfeit-checks>.

¹⁵ See https://tcva.fms.treas.gov/approot/tcva/TCVA_Welcome.html.

¹⁶ See <https://about.usps.com/notices/not299.pdf>; the New York Times published an article in 2005 detailing the increase in counterfeit postal money orders. Tom Zeller Jr., “Authorities Note Surge in Online Fraud Involving Money Orders,” *New York Times*, April 26, 2005, available at <http://query.nytimes.com/gst/fullpage.html?res=9907EED81231F935A15757C0A9639C8B63>.

NEWS FROM WASHINGTON: REGULATORY UPDATES*

The Consumer Financial Protection Bureau (CFPB) amends its prepaid accounts rule. On January 25, 2018, the CFPB amended its prepaid accounts rule. The changes include:

- delaying the scheduled effective date from April 1, 2018, to April 1, 2019;
- providing that financial institutions are not required to resolve errors or limit consumers' liability on unverified prepaid accounts. If a consumer's identity is later verified, institutions are not required to limit liability and investigate errors for disputed transactions that occurred prior to verification; and
- providing more flexibility for certain credit cards linked to digital wallets by creating a limited exception to Regulation Z's prepaid card provisions for certain business arrangements between prepaid account issuers and credit card issuers that offer traditional credit card products.

The *Federal Register* notice is available at <https://www.govinfo.gov/content/pkg/FR-2018-02-13/pdf/2018-01305.pdf>.

The federal bank regulatory agencies announce they will give favorable Community Reinvestment Act (CRA) consideration to activities to revitalize or stabilize the U.S. Virgin Islands and Puerto Rico following Hurricane Maria. On January 25, 2018, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (OCC) (the agencies) announced that they will provide favorable CRA consideration to community development activities that help to revitalize or stabilize these disaster areas by financial institutions located anywhere in the United States, provided they have been responsive to the community development needs and opportunities of their own CRA assessment area(s).

Ordinarily, community development activity receives favorable CRA consideration when it benefits a bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s), even when the benefit to the assessment area(s) is not immediate or direct. Additionally, if an institution has been responsive to the needs of its assessment area(s), it may receive consideration for community development activity in the broader statewide or regional area that includes its assessment area(s) regardless of whether it benefits the assessment area(s).

Hurricane Maria, however, caused widespread devastation in areas not connected to the mainland but have experienced economic impact and other effects that may extend to other parts of the nation. The agencies stated that CRA consideration for related revitalization and stabilization activities will be given regardless of the median income of the census tract or the personal income of the individual, but they may give greater weight to activities that are most responsive to community needs, including the needs of low- and moderate-income areas and individuals. The interagency statement is available at <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180125a1.pdf>.

The House of Representatives and the Senate pass bills exempting certain depository institutions from the new Home Mortgage Disclosure Act (HMDA) requirements. On January 18, 2018, the House passed H.R.2954, the Home Mortgage Disclosure Adjustment Act. The bill exempts certain depository institutions from collecting and reporting various expanded HMDA data points in the CFPB's 2015 amendments to Regulation C that became effective on January 1, 2018. Depository institutions originating fewer than 500 closed-end mortgage loans or fewer than 500 open-end lines of credit would receive regulatory relief in connection with expanded data points required by the amended regulation for, respectively, their closed-end mortgage loans or their open-end lines of credit.

On March 14, 2018, the Senate passed S.2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act, a broader bill that contains similar provisions. If the HMDA provisions in these bills are reconciled and passed into law, depository institutions eligible for the exemptions would still need to collect and report HMDA data points required prior to the amended regulation's January 1, 2018, effective date.

The CFPB issues its biennial report on the consumer credit card market. On December 27, 2017, the CFPB released an updated report, *The Consumer Credit Card Market*, which it last issued in December 2015. The report's major findings include that:

- the total amount of credit line, used or unused, on credit cards remains below the levels prior to the financial crisis but has steadily increased since the crisis;
- new credit card originations remain below volumes prior to the crisis but have increased by roughly 50 percent since 2010;
- average credit card debt increased 9 percent over the last two years;

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



- more than 60 percent of active credit card accounts are enrolled in online services to track spending, pay bills, and conduct other account activities;
- cardholders have on average fewer credit cards than before the recession; for example, prime borrowers on average had five cards before the recession and now have an average of four cards; and
- more consumers are signing up for secured cards that require a cash deposit.

The complete report is available at https://files.consumerfinance.gov/f/documents/cfpb_consumer-credit-card-market-report_2017.pdf.

The Federal Financial Institutions Examination Council (FFIEC) agencies announce supervisory expectations regarding compliance with HMDA amendments. On December 21, 2017, the Federal Reserve Board issued Consumer Affairs (CA) Letter 17-4, which transmits its expectations regarding early examinations of supervised institutions for compliance with amended Regulation C.

Recognizing that complying with the amended regulation will involve significant system and operational challenges, the Federal Reserve will not require HMDA data collected in 2018 and submitted in 2019 to be resubmitted unless any errors are material. The Federal Reserve likewise does not intend to assess penalties regarding HMDA data collected in 2018 and submitted in 2019. Rather, examinations of such 2018 HMDA data will be diagnostic to help institutions identify compliance weaknesses and will credit good faith compliance efforts. The other FFIEC agencies issued similar statements. CA Letter 17-4 is available at <https://www.federalreserve.gov/supervisionreg/caletters/caltr1704.htm>.

In its statement, the CFPB also indicated that it intends to reconsider aspects of amended Regulation C to include its institutional and transactional coverage tests and discretionary data points. The discretionary data points are those that the CFPB elected to add in its October 2015 final rule amending Regulation C, apart from the compulsory additional HMDA data points specified in §1094 of the Dodd–Frank Wall Street Reform and Consumer Protection Act.

The CFPB announces that it may reconsider its recently issued Payday Rule. On November 17, 2017, the CFPB issued its Payday Rule amending Regulation E

(which implements the Electronic Fund Transfer Act) and Regulation Z (which implements the Truth in Lending Act (TILA)), in connection with payday, vehicle title, and certain high-cost installment loans. The rule has two primary components: (1) for short-term and longer-term loans with balloon payment features, it indicates that it would be an unfair and abusive practice for a lender to extend such loans without a reasonable determination that consumers have the ability to repay the loans; and (2) for those loans and for longer-term loans with annual percentage rates over 36 percent that are repaid directly from consumers' accounts, it indicates that it would be an unfair and abusive practice to attempt to withdraw payments from a consumer's account after two successive unsuccessful payment attempts, unless a lender receives the consumer's authorization to make further withdrawals.

The compliance date for most of the provisions of the final rule is August 19, 2019. On January 16, 2018, however, the CFPB announced that it intends to conduct a rulemaking so that it may reconsider the final rule.

The *Federal Register* notice for the final rule is available at <https://www.federalregister.gov/documents/2017/11/17/2017-21808/payday-vehicle-title-and-certain-high-cost-installment-loans>.

The CFPB announcement is available at <https://www.consumerfinance.gov/about-us/newsroom/cfpb-statement-payday-rule/>.

The Federal Reserve Board and two other agencies announce adjustments to the threshold for the smaller loan exemption from appraisal requirements for higher-priced mortgage loans. On November 9, 2017, the Federal Reserve Board, the CFPB, and the OCC announced that the threshold exempting loans from the special appraisal requirements for higher-priced mortgage loans increased from \$25,500 in 2017 to \$26,000 in 2018, based on the annual percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). Special appraisal requirements for higher-priced mortgage loans include a requirement that creditors obtain a written appraisal based on a physical visit to the home's interior before making a higher-priced mortgage loan.

For loans made between January 1, 2018, and December 31, 2018, higher-priced mortgage loans of \$26,000 or less are exempt from the special appraisal requirements. ■

ON THE DOCKET: RECENT FEDERAL COURT OPINIONS*

REGULATION Z — TRUTH IN LENDING ACT (TILA)

The Eighth Circuit rejects rescission attempt by borrowers who signed an acknowledgment of a receipt of two copies of a notice of right to rescind. *Jesinoski v. Countrywide Home Loans, Inc.*, 883 F.3d 1010 (8th Cir. 2018). Under the TILA, 15 U.S.C. §1635(a), and Regulation Z, 12 C.F.R. §1026.23(a), a consumer has three business days to rescind certain credit transactions secured by the consumer's principal dwelling. But this right can be extended to three years if the creditor fails to provide the consumer with either all material TILA disclosures (as defined in Regulation Z) or, generally, two copies of a notice of the right to rescind. *Jesinoski* is the latest action in a lengthy litigation that went to the U.S. Supreme Court in 2015 (where the court held that the three-year limit applied to the date the borrower sent the creditor the notice of rescission, rather than when a rescission lawsuit was filed, and remanded to the lower courts for a decision on the merits). The borrowers sought to rescind their loan because they alleged that the lender only provided one copy of the rescission rights notice to each plaintiff, rather than two to each. However, the borrowers had each signed a form acknowledging receipt of two copies of the notice. Under §1635(c) of TILA, a signed acknowledgment form creates a rebuttable presumption that the lender properly provided the required notices. The borrowers argued the acknowledgment provided to them was ambiguous as to the number of copies received and asserted that they had not received all necessary copies. The district court found that the borrowers did not present sufficient evidence to raise questions about the rebuttable presumption and granted summary judgment in favor of the lender. The Eighth Circuit agreed and accordingly affirmed the district court's decision.

REGULATION X — REAL ESTATE SETTLEMENT PRACTICES ACT (RESPA)

The D.C. Circuit Court of Appeals, sitting en banc,¹ reverses panel's ruling that the Consumer Financial Protection Bureau's single-director structure is unconstitutional. *PHH Corporation v. Consumer Financial Protection Bureau*, 881 F.3d 75 (D.C. Cir. 2018) (en banc). In 2014, the CFPB began an administrative proceeding against PHH, a residential mortgage lender, and Atrium, its captive reinsurer, alleging they violated prohibitions against kickbacks and unearned fees under §8(a) of RESPA, 12 U.S.C. §2607(a), by receiving referral fees from private mortgage insurers disguised as reinsurance premiums. When PHH originated a loan requiring private mortgage insurance (PMI), PHH provided the borrower with a list of insurers, all of whom contractually agreed to purchase reinsurance from Atrium if selected to provide PMI.

An administrative law judge agreed with the CFPB that the reinsurance premiums paid to Atrium constituted referral fees prohibited by §8(a) of RESPA and recommended that Atrium disgorge \$6.4 million as a penalty. On appeal, the director of the CFPB read RESPA to support a broader finding of misconduct and that the three-year statute of limitations did not apply to administrative enforcement proceedings. Accordingly, the director adjusted the disgorgement penalty to \$109 million. PHH appealed to the D.C. Court of Appeals.

In October 2016, the court held that a safe harbor found in §8(c)(2) of RESPA permits a service provider such as Atrium to receive payments for the reasonable market value of "goods or facilities actually furnished or for services actually performed." The court further held that the CFPB could not retroactively change the U.S. Department of Housing and Urban Development (HUD)'s prior guidance, upon which industry had relied, allowing "captive reinsurance arrangements so long as the mortgage insurer paid no more than reasonable market value for the reinsurance." The court also held that RESPA's three-year statute of limitations applies to administrative enforcement actions. Finally, the panel found the CFPB to be unconstitutionally structured because it is an independent agency headed by a single director who could only be removed for cause. However, the court also found that it could remedy the constitutional issue by severing the provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act that only allowed the CFPB's director to be fired for cause, thus allowing the president to remove the director without cause.

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

¹ *En banc* means the entire court instead of the usual panel of judges who decide the appeal.



The CFPB successfully petitioned for review en banc of the panel’s decision. In January 2018, the court reinstated the panel’s rulings on the interpretation of RESPA and its statute of limitations. However, the court reversed the panel’s ruling that the CFPB’s structure was unconstitutional, holding that its structure is consistent with the president’s constitutional authority and prior Supreme Court decisions. As a result, the penalty against PHH was vacated, and the case was remanded to the CFPB for further proceedings.

FAIR HOUSING ACT

The Supreme Court holds that the City of Miami has standing to sue lenders under the Fair Housing Act (FHA) for alleged reverse redlining but remands to lower courts to decide whether the city had asserted a direct enough connection between the banks’ actions and alleged harm to establish damages. *Bank of America Corp. et al. v. City of Miami*, 137 S. Ct. 1296 (2017). In 2013, the City of Miami sued Bank of America and Wells Fargo under the FHA, alleging discrimination against Hispanic and African American mortgage borrowers, resulting in economic damages to the city. In particular, the city alleged the banks violated the FHA by originating riskier mortgages on less favorable loan terms to these borrowers than to similarly situated white borrowers (a practice known as reverse redlining) and by failing to refinance or perform loan modifications. The city alleged that this resulted in increased foreclosures in minority neighborhoods, which decreased property tax revenue and increased the demand for city services to address foreclosure blight.

Generally, the FHA permits an “aggrieved person,” broadly defined to include someone who “claims to have been injured by a discriminatory housing practice,” to file a lawsuit for violations of the FHA. U.S.C. 42 §3602(i)(1). The Supreme Court affirmed the Eleventh Circuit’s holding that the city was an “aggrieved person” under the FHA and accordingly had standing to bring a lawsuit. In contrast, the court rejected the Eleventh Circuit’s ruling that any “foreseeable damages” could be recovered. Instead, the court held the plaintiff must establish “some direct relation between the injury asserted and the injurious conduct alleged” and remanded the case to the lower courts to decide if the city’s claims for lost property-tax revenue and increased municipal expenses qualify under this standard.

FAIR DEBT COLLECTION PRACTICES ACT

The Third Circuit holds that a debt collector’s letter proposing to settle a time-barred debt could violate the Fair Debt Collection Practices Act (FDCPA). *Tatis v. Allied Interstate, LLC*, 882 F.3d 422 (3d Cir. 2018). The FDCPA prohibits “any false, deceptive, or misleading representation or means in connection with the collection of any debt.” 15 U.S.C. §1692(e). Courts employ a “least-sophisticated debtor” standard to evaluate whether a representation is misleading. The plaintiff’s class-action lawsuit alleged that the defendant debt collector violated the FDCPA by sending a letter to the plaintiff proposing to settle her 10-year-old debt to Bally Total Fitness Holding Corp.

Because the statute of limitations in New Jersey, where the plaintiff resides, is six years, the debt collector could not file a lawsuit to collect it. The Third Circuit previously held in *Huertas v. Galaxy Asset Management*, 641 F.3d 28 (3d Cir. 2011) that a debt collector’s attempt to seek voluntary repayment of an unenforceable debt after the state of limitations had expired did not violate the FDCPA because the debt collector did not threaten legal action. In *Tatis*, the defendant argued that it did not violate the FDCPA because it did not threaten legal action. However, the court found that the least sophisticated debtor could plausibly believe that the settlement offer could connote litigation, potentially misleading the debtor into believing Allied could legally enforce the debt “because settlement of the debt” referred to the creditor’s ability to enforce the debt in court rather than a mere invitation to settle the account. The case was remanded to the trial court for further proceedings.

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CALENDAR OF EVENTS 2018

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| June 24–27 | ABA Regulatory Compliance Conference
Music City Center, Nashville, TN |
| October 13–19 | ABA Compliance School — Foundational
Emory Conference Center Hotel, Atlanta, GA |
| October 15–19 | ABA Compliance School — Advanced
Emory Conference Center Hotel, Atlanta, GA |

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RECORD RETENTION REQUIREMENTS FOR FEDERAL CONSUMER PROTECTION LAWS AND REGULATIONS

Most federal consumer protection laws and regulations require providers of financial products and services to retain records of compliance for a specified period. To facilitate compliance, we have listed a high-level summary of the retention requirements for select federal consumer protection laws and regulations. We have designed this chart as a pullout for easy future reference so, for example, if a compliance officer has a question about the retention requirements for Regulation B, the chart would provide a summary and a link to the regulation for details. The chart is intended to provide a quick overview but is not a substitute for reviewing the applicable statute or regulation. The chart is limited to the specific laws listed, and other state or federal laws could also apply.

Regulation/ Statute	Citation	Requirement ¹	Retention Period ²
Regulation B/Equal Credit Opportunity Act (ECOA)	12 C.F.R. §1002.12	Maintain applications and required notifications, including written statements alleging violations, prescreened solicitations, related selection criteria, complaints correspondence, self-test documentation, right-to-appraisal notice, adverse action notices, and ECOA notices. Must also maintain records of fair lending self-test	For consumer transactions and self-testing, 25 months after date of notice For commercial transactions, 12 months, with a special rule for business credit applications in §1002.12(b)(5). For enforcement proceedings and investigations, the period is extended (§1002.12(b)(4))
Regulation C/Home Mortgage Disclosure Act (HMDA)	12 C.F.R. §1003.5(a)(1), (d)	Maintain loan/application register (LAR) and public disclosure statement	3 years — LAR 5 years — disclosure statement
Regulation E/Electronic Fund Transfer Act (EFTA)	12 C.F.R. §1005.13(b), .33(g)(2)	Maintain evidence of compliance as required by the EFTA and Regulation E, including (but not limited to) error-related documentation	2 years
Regulation G/Secure and Fair Enforcement for Mortgage Licensing (SAFE) Act	12 C.F.R. §1007.104(h)	Maintain records of registrants' criminal history background reports and actions taken	Does not specify
Regulation H/Flood Disaster Protection Act of 1973 ³	12 C.F.R. §208.25(i)(3), (4) and .25(f)(2)	Retain a record of the special flood hazard determination form and receipt of notices to the borrower and servicer, force-placed notices, and evidence of flood insurance if required	Life of the loan

¹This information is paraphrased from the law or regulation. The applicable law or regulation contains more details.

²This identifies the *period* that a record must be retained, not what triggers the retention period (e.g., application or date notice sent).

³Each federal banking agency codifies the flood implementing regulations in their respective regulations. We have provided the citation for the Federal Reserve's flood implementing regulations. The other agencies' flood insurance record retention requirements, which are substantially similar, appear in 12 C.F.R. Part 22.9(d),(e) for institutions supervised by the Office of the Comptroller of the Currency; 12 C.F.R. Part 339(d),(e) for institutions supervised by the Federal Deposit Insurance Corporation; and 12 C.F.R. Part 760.9(d),(e) for institutions supervised by the National Credit Union Administration.

RECORD RETENTION REQUIREMENTS FOR FEDERAL CONSUMER PROTECTION LAWS AND REGULATIONS

Regulation/ Statute	Citation	Requirement	Retention Period
Regulation M/ Consumer Leasing Act	12 C.F.R. §1013.8	Retain evidence of compliance with Regulation M, including having performed required actions (except advertising) and having made required disclosures	2 years
Regulation V/Fair Credit Reporting Act (implementing regulations for accuracy and integrity requirements)	Appendix E to 12 C.F.R. Part 1022	Maintain records to substantiate accuracy of consumer information furnished to credit reporting agencies that is subject to a direct dispute	Reasonable period of time, but not less than any applicable recordkeeping requirement to substantiate the accuracy of any information about consumers it furnishes that is subject to a direct dispute
Regulation X/Real Estate Settlement Procedures Act	12 C.F.R. §§1024.10(e), 14(h), 15(d)	Retain HUD-1/HUD-1A (if applicable), documents relating to kickbacks and unearned fees and affiliated business arrangements	5 years after settlement
	12 C.F.R. §1024.38(c) Small servicers, as defined in §1026.41(e) (4), are exempt from §1024.38(c)'s requirements	<p>Servicer must retain records documenting actions taken for a mortgage loan account, including servicing disclosure statements</p> <p>In addition to the record retention requirements, the servicer must maintain an accessible servicer file accessed within 5 days and contains transactions credited or debited to the account, including escrow and suspense accounts, the security instrument, servicers' notes for communications with the borrower, and any documents the borrower provided to the servicer</p>	1 year after loan is discharged or servicing is transferred

RECORD RETENTION REQUIREMENTS FOR FEDERAL CONSUMER PROTECTION LAWS AND REGULATIONS

Regulation/ Statute	Citation	Requirement	Retention Period
Regulation Z/Truth in Lending Act (TILA)	12 C.F.R. §1026.25	Retain evidence of compliance with exceptions noted below	2 years – agencies may require longer retention periods
	§1026.25(c)(1)(i), 25(c)(2)	Retain records for loan originator compensation, ability-to-repay requirements in §1026.43, and loans secured by real property, except closing disclosure, which are covered below	3 years
	§1026.25(c)(1)(ii)(A)	Retain closing disclosure	5 years
	§1026.25(c)(1)(ii)(B)	Must provide records to new owner or new servicer if loan is sold or a new servicer is appointed who must retain records for balance of 5 years. The creditor must also retain evidence that it performed the required actions and issued the required disclosures	5 years
Regulation CC/ Expedited Funds Availability Act	12 C.F.R. §229.21(g)	Retain evidence of procedures to ensure receipt of disclosures and notices and to prove compliance with funds availability. Must also retain copies of “reasonable cause” exceptions under §229.13(g) and description of why exceptions apply	2 years
Regulation DD/Truth in Savings Act	12 C.F.R. §1030.9	Retain evidence of compliance and show evidence that procedures are followed (e.g., information of rate and balances to verify interest properly paid). Sample disclosures must be kept	Minimum 2 years — agencies may require longer retention periods
Regulation BB/ Community Reinvestment Act (CRA)	12 C.F.R. §228.43 ⁴	CRA disclosure statement CRA public file, including written comments, assessment areas, branch information, and HMDA disclosure statement (if bank is an HMDA reporter) Written comments about CRA performance and the bank’s responses Most recent public CRA performance evaluation	Current and prior 2 calendar years

⁴ We have provided the citation to the Federal Reserve’s CRA implementing regulations. The other agencies’ record retention requirements for CRA, which are substantially similar, appear in 12 C.F.R. Part 195.43 for federal savings associations supervised by the Office of the Comptroller of the Currency; 12 C.F.R. Part 25.43 for national banks supervised by the Office of the Comptroller of the Currency; and 12 C.F.R. Part 345.43 for state nonmember banks supervised by the Federal Deposit Insurance Corporation.

RECORD RETENTION REQUIREMENTS FOR FEDERAL CONSUMER PROTECTION LAWS AND REGULATIONS

Regulation/ Statute	Citation	Requirement	Retention Period
Servicemembers Civil Relief Act (SCRA)	50 U.S.C. §3901 et seq.	The SCRA does not impose recordkeeping requirements; however, examiners may want to view SCRA records to verify compliance	N/A
Fair Credit Reporting Act (FCRA)	15 U.S.C. §1681(m)	Creditors or insurance companies making prescreened offers of credit or insurance based on consumer reports must retain criteria used to make the offer and the requirements that apply to loan if secured	3 years
	15 U.S.C. §1681(w); 12 C.F.R. Part 208, App. D-2	While the focus of this article has been on record retention, the FCRA also requires that when financial institutions dispose of certain sensitive consumer information, they take reasonable measures to protect against unauthorized access to or use of the information in connection with its disposal	

A discussion of record retention must include the Electronic Signatures in Global and National Commerce Act (E-Sign Act), 15 U.S.C. 7001(d)(1) et seq. The E-Sign Act was designed to facilitate electronic commerce by providing that the validity or enforceability of a contract, electronic record, or signature for a transaction affecting interstate commerce (subject to certain exceptions) cannot be challenged solely because it is in electronic form or because an electronic signature or record was used to form the contract. For purposes of this article and chart, the E-Sign Act also provides that if a law requires the record of a transaction to be retained, an electronic record satisfies this requirement. To comply with the E-Sign Act for recordkeeping purposes, an electronic record must:

- accurately reflect the information in the contract or other record,
- be retained in a form that reflects the information in the contract or other record,
- be accessible to people entitled to view the information for the period the law requires, and
- be in a form that can be retained and later reproduced.⁵

Specific questions should be directed to your primary regulator.

⁵ 15 U.S.C. §7001(d)(1) and 15 U.S.C. §7001(e). *Outlook* discussed the compliance requirements for the E-Sign Act in a 2009 article titled “Moving from Paper to Electronics: Consumer Compliance Under the E-Sign Act,” available at https://consumercomplianceoutlook.org/2009/fourth-quarter/q4_02/.