

CONSUMER COMPLIANCE OUTLOOK®

A FEDERAL RESERVE SYSTEM PUBLICATION FOCUSING ON CONSUMER COMPLIANCE TOPICS

INSIDE

Celebrating 10 Years of <i>Consumer Compliance Outlook</i>	6
Escrow Accounting Rules: Are You in Compliance?.....	8
Regulatory Calendar	11
News from Washington.....	12
On the Docket	14
Calendar of Events	16

HOW SHOULD FINANCIAL INSTITUTIONS PREPARE FOR A CONSUMER COMPLIANCE EXAMINATION?¹

BY SCOTT SONBUCHNER, EXAMINER, FEDERAL RESERVE BANK OF MINNEAPOLIS

Abraham Lincoln famously said: “Give me six hours to chop down a tree and I will spend the first four sharpening the axe.” For financial institutions undergoing a compliance examination, the wisdom of these words is especially true because preparing for the examination will reduce stress levels, help the examination run smoothly and efficiently, and allow financial institutions to manage the demands placed on compliance staff, management, and other staff in the organization.

For many institutions, preparing for examinations is more challenging because of significant changes in consumer protection regulations and supervision following the financial crisis. In 2010, Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act, and in 2013, the Board of Governors of the Federal Reserve System issued an updated risk-focused supervisory program that emphasizes tailoring examinations to a bank’s risk profile.² Then in 2017, the Federal Financial Institutions Examination Council updated the Uniform Interagency Consumer Compliance Rating System to revise the framework examiners use for evaluating an institution’s compliance management system. With all these significant changes, even tenured compliance officers are likely to ask a critical question: How can my institution better prepare for its upcoming consumer compliance examination?

This article discusses the Federal Reserve’s typical examination process to provide insights into the purpose of each stage and the work involved. The article also provides specific suggestions about how financial institution managers and compliance officers can prepare for their next consumer compliance examination. By reviewing and understanding the examination process, financial institutions can appropriately budget time and resources, and compliance officers will be better equipped to facilitate an efficient and effective examination.

Review of the Examination Process³

The First-Request Letter

The first-request letter is a detailed questionnaire that requests specific documents and asks questions about the institution’s compliance management program and factors that contribute to the bank’s inherent consumer compliance risk. Examiners pair the bank’s first-request letter responses with interviews about the bank’s compliance program and business line controls. Examiners use this information during the scoping and risk assessment phase to develop the bank’s detailed risk profile.

CONTINUED ON THE NEXT PAGE

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FEDERAL RESERVE BANK OF PHILADELPHIA

HOW SHOULD FINANCIAL INSTITUTIONS PREPARE FOR A CONSUMER COMPLIANCE EXAMINATION?¹

CONTINUED FROM PAGE 1

Risk Assessment and Scoping

Before the Federal Reserve implemented risk-focused examinations in 2013, the traditional compliance examination often involved reviewing all products, services, and activities at each financial institution. This approach meant that examiners developed a less-detailed institutional profile before visiting the financial institution, and the examination scope was virtually unchanged from institution to institution. In contrast, risk-focused examinations consider the institution's risk profile, including the inherent consumer compliance risk associated with its products and services and how effectively it identifies and manages this risk. To effectively scope a risk-focused examination before arriving onsite, examiners create a more detailed institutional profile to understand the unique characteristics of each institution and perform a thorough risk assessment of its products and services. This additional work on the front end of the examination process streamlines the overall assessment by focusing exam activities on the areas of highest risk.

Risk-focused examinations align examination activities with the residual risk of an institution's products, services, and activities. Higher-residual risk areas receive higher-intensity reviews, and lower residual risk areas receive lower-intensity reviews or no review at all. Transaction testing (i.e., reviewing a sample of consumer transactions to verify compliance) is associated with a higher-intensity review, whereas interviews of key institution staff may be sufficient for a lower-intensity review. Transaction testing may also involve either a full or a targeted review of prior transactions for compliance with regulatory requirements. Financial institution managers and compliance officers should be able to discern the areas that the examiner-in-charge (EIC) deems to be higher risk, based on the files and documents requested in the second-request letter and the interviews that the EIC schedules during the examination.

The Second-Request Letter

As part of a risk-focused approach, some Reserve Banks may use a second-request letter. While the first-request letter typically asks for a broad range of documents and information, the second-request letter is a tailored document that focuses on the institution's higher-risk areas. The documents requested in the second-request letter generally reflect the EIC's scoping decisions, and they will be the focus of the majority of the onsite examination. Examiners usually perform transaction testing on documents requested in the second-request letter.

Onsite Examination

Once onsite, examiners will continue the examination by conducting transaction testing, interviewing staff, and investigating possible violations. How much time examiners spend onsite will vary, depending on the size, complexity, and risk profile of the institution.

Closing meetings summarize examiner findings from the scoping and examination process. Ideally, these meetings do not surprise financial institution management or compliance officers because examiners are expected to discuss issues with the institution's management during the examination. Examiners will review any identified violations and provide observations about the effectiveness of the bank's compliance management program. Additionally, if examiners identify notices of "Matters Requiring Attention" or "Matters Requiring Immediate Attention," they will also discuss these topics at the closing meetings. Reserve Banks will issue the final report no later than 60 days after the examination closing date.

Preparing for the Examination Process

How can a financial institution's management and compliance staff prepare for an upcoming consumer compliance examination? The following sections group preparation practices in relation to the examination process. The first section offers suggestions appropriate for banks that have not yet received their first-request letter and therefore have more time to deliberate and research before their next examination. When a bank receives its first-request letter, it shifts to a tactical response. Finally, when a bank receives its second-request letter, the focus turns to practical advice for managing the remainder of the process.

Before the Examination Process Begins

To maintain an effective compliance program, institutions often review relevant federal guidance, previous examination results, and their own processes. These ongoing procedures can help institutions prepare for the next examination. But once an examination begins, institutions typically have limited time to dedicate to these tasks, so early planning can have long-term benefits. To prepare, institutions may consider the following suggestions:

- **Review Relevant Guidance.** Reserve Bank examiners receive training on and are required to follow Consumer Affairs Letters (CA Letters). The Federal Reserve's Division of Consumer and Community Affairs issues CA Letters to communicate significant policy and procedural matters related to the Federal Reserve System's consumer compliance supervisory responsibilities. For this reason, financial institution management teams and compliance officers should familiarize themselves with the guidance contained in these letters.⁴ In particular, the following two important topics are addressed in CA Letters:

- The Community Bank Risk-Focused Consumer Compliance Supervision Program⁵ provides the framework that examiners use to determine whether an institution is effectively controlling its compliance risk. Therefore, understanding this program is essential to understanding

how examiners scope and examine a financial institution's compliance management systems. The program can also be helpful in guiding a financial institution in setting up its own compliance risk assessment processes.

- The new Uniform Interagency Consumer Compliance Rating System⁶ provides the updated rating system that complements the current risk-focused examination approach. While this new rating system does not set new or higher supervisory expectations, it does provide a new framework that highlights the different assessment factors used to determine an institution's consumer compliance rating. Institutions may find that these factors receive more attention during their next examination because the report of examination now addresses these factors in the compliance ratings analysis.⁷
- **Review Previous Report of Examination.** Review the institution's previous consumer compliance report of examination. This report details how examiners evaluated the institution's compliance management system at the previous consumer compliance examination and any matters that required management's attention. This document determines which pillars of the institution's compliance management system that examiners determined were strong, satisfactory, or in need of improvement. It is also worth considering what has changed at the bank since the previous examination that could have affected these assessments.
- **Review Any Corrective Action Processes.** Be prepared to discuss the financial institution's processes for taking corrective action. Once an institution identifies an issue, it should have a process in place to remedy the issue and verify that it does not reoccur. This process should include finding the issue's root cause, following up with the appropriate staff and management, implementing a solution, and monitoring ongoing performance to ensure the issue does not happen again. One way to demonstrate an effective corrective action program is to document that the institution has adequately addressed issues from the previous examination, audits, and internal reviews. The EIC is likely to follow up on these issues, so it is helpful if the financial institution addresses these areas before its next examination.
- **Review Change Management Processes.** Be ready to share the financial institution's story of how its compliance management system identifies and responds to change. Change often increases compliance risk, whereas a lack of change may suggest that existing satisfactory controls are still effective. Sources of change may include new regulatory requirements, new products, new vendors, increased volume for existing products,

changes in management structure, and an increase in the number of branches. Successful compliance management systems anticipate change, evaluate its significance, and implement responses across impacted business lines.

- **Review Consumer Complaints.** Be prepared to explain and to show how the institution addresses consumer complaints, which can provide an opportunity to reevaluate the financial institution's controls. Institutions with a strong compliance management system collect consumer complaints from all sources: branch locations, emails, or voice mails, even social media. Complaints, especially when a trend is identified, can indicate possible deficiencies in a compliance management system. Effective compliance programs ensure that management takes appropriate corrective action to address any identified deficiencies revealed in the complaint resolution process.

With a better understanding of the mechanics of consumer compliance examinations, bankers can reduce examination stress levels ...

During the Examination Process

Once an institution receives a first-request letter, it will begin to gather documents and oversee the examination process. To manage the document-gathering process for examiners, many financial institutions appoint a central point of contact, who is often the compliance officer. Here are some suggestions on how to be strategic with bank resources and manage examiner expectations once the examination begins.

- **Understanding the First-Request Letter** — The primary purpose of the first-request letter is to provide examiners with information that enables them to assess the institution's residual risk for each of its products, services, and activities. Financial institutions should evaluate information requests with this in mind. Institutions should not interpret questions too narrowly. Instead, they should think of information requests as an opportunity to help examiners learn about the institution's risk profile, which will ultimately lead to a more accurate and tailored examination scope.

- **Responding to Requests.** When reviewing the first-request letter, if any individual request raises questions or seems excessively burdensome, the central point of contact can ask the EIC to clarify why the requested information is needed or propose alternatives. This approach helps ensure that the information-gathering process is as effective as possible.
- **Providing Scoping Oversight.** Before the onsite examination interviews begin, examiners often conduct interviews with business-line personnel as part of the examination scoping process. Institutions may consider appointing a central person, possibly the compliance officer, to attend the interviews, if possible. These interviews give the compliance officer a better understanding of the examination's focus and provide opportunities to ensure that examiners receive complete responses to their inquiries.

After scoping the examination, the EIC should have an understanding of how many examiners will visit the financial institution and the extent of their stay. It won't be long before the second-request letter arrives, and the institution should start planning to have examiners in the building. Here are some practical suggestions for managing the process:

- **Clarify Details.** Confirm the arrival date and the number of onsite examiners so the financial institution can reserve a working space large enough to accommodate them.
- **Examination Oversight.** The compliance officer or other designee should offer to schedule any interviews and confirm that needed employees will be present. As schedules permit, financial institutions should schedule more tenured employees for interviews because they are more experienced with the institution's practices.
- **Closing Report.** At the closing meeting, examiners will confirm if the examination is finished. If so, the institution can expect to receive the examination report within 60 days. If not, the institution can consider offering assistance with any outstanding matters.

CONCLUSION

With a better understanding of the mechanics of consumer compliance examinations, bankers can reduce examination stress levels and perhaps even anticipate what to expect at different stages of the examination process. Financial institution management and compliance officers can prepare for their next consumer compliance examination, which can help limit the number of surprises during the examination and help examiners reach their conclusions efficiently. For specific questions about your next examination, state member banks should contact their Reserve Bank consumer compliance team. ■

ENDNOTES

¹ This article specifically addresses the consumer compliance examination process for state-chartered banks that are members of the Federal Reserve System. While we believe many of the practices are generally applicable to financial institutions, readers should establish examination expectations with their institution's specific regulator.

² *Consumer Compliance Outlook* reviewed the new program in 2014; Jeffrey Drum, "Risk-Focused Consumer Compliance Supervision Program for Community Banks," *Consumer Compliance Outlook* (Second Quarter 2014). This program applies to state-chartered banks that are members of the Federal Reserve System.

³ The processes described are typical, but financial institution management may experience some differences. For example, you may interact with a variety of Reserve Bank examination staff throughout the examination preparation and scoping processes. In addition, the timing or sequence of certain events could vary.

⁴ The Federal Reserve's collection of CA Letters is available at <https://www.federalreserve.gov/supervisionreg/caletters/caletters.htm>.

⁵ See CA Letter 13-19, "Community Bank Risk-Focused Consumer Compliance Supervision Program," November 18, 2013, available at <https://www.federalreserve.gov/supervisionreg/caletters/caltr1319.htm>.

⁶ See CA Letter 16-8, "Uniform Interagency Consumer Compliance Rating System," November 22, 2016, available at www.federalreserve.gov/bankinfo/reg/caletters/caltr1608.htm.

⁷ For a more in-depth discussion of the factors that comprise the new consumer compliance rating system, see Lanette Meister, "Implementing the New Uniform Interagency Consumer Compliance Rating System," *Consumer Compliance Outlook* (First Issue 2017).

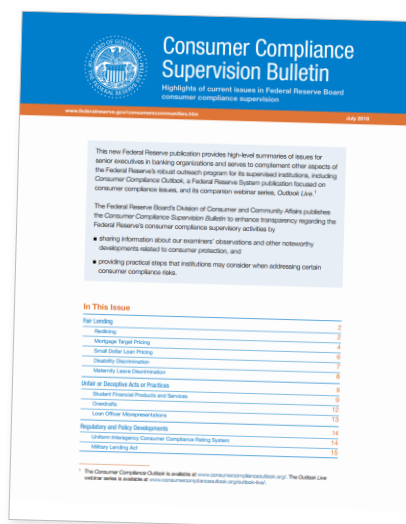
BOARD LAUNCHES CONSUMER COMPLIANCE SUPERVISION BULLETIN

The Federal Reserve Board recently launched the *Consumer Compliance Supervision Bulletin*, a new publication to provide bankers and others parties interested in consumer protection with high-level summaries of pertinent supervisory issues. The *Bulletin* complements the Federal Reserve System's other outreach programs for banking organizations, including *Consumer Compliance Outlook* and its companion webinar series, *Outlook Live*.

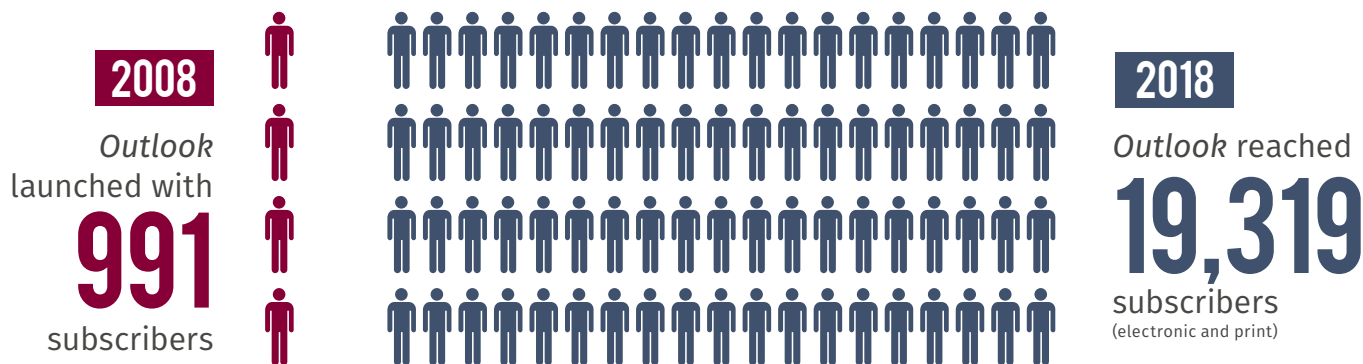
The *Bulletin*, which will be published by the Board's Division of Consumer and Community Affairs, is intended to enhance transparency regarding the Federal Reserve's consumer compliance supervisory program and highlight violations that have been identified. It will also provide practical steps for institutions to consider when managing consumer compliance risks.

The inaugural issue of the *Bulletin* focuses on the illegal discrimination practice known as *redlining* as well as discriminatory loan pricing and underwriting. The issue also discusses unfair or deceptive acts or practices involving overdrafts, loan officer misrepresentations, and products and services marketed to students. Finally, the *Bulletin* briefly highlights recent regulatory and policy developments.

The *Bulletin* is available on the Board's website at <https://www.federalreserve.gov/publications/2018-july-consumer-compliance-supervision-bulletin.htm>.



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“ Our commitment to transparency also includes a robust outreach program for banks. This includes *Consumer Compliance Outlook*, a widely subscribed Federal Reserve System publication focused on consumer compliance issues, and its companion webinar series, *Outlook Live*. ”

— Randal K. Quarles, Reserve Board Vice Chairman for Supervision, during a 2018 speech in Atlanta

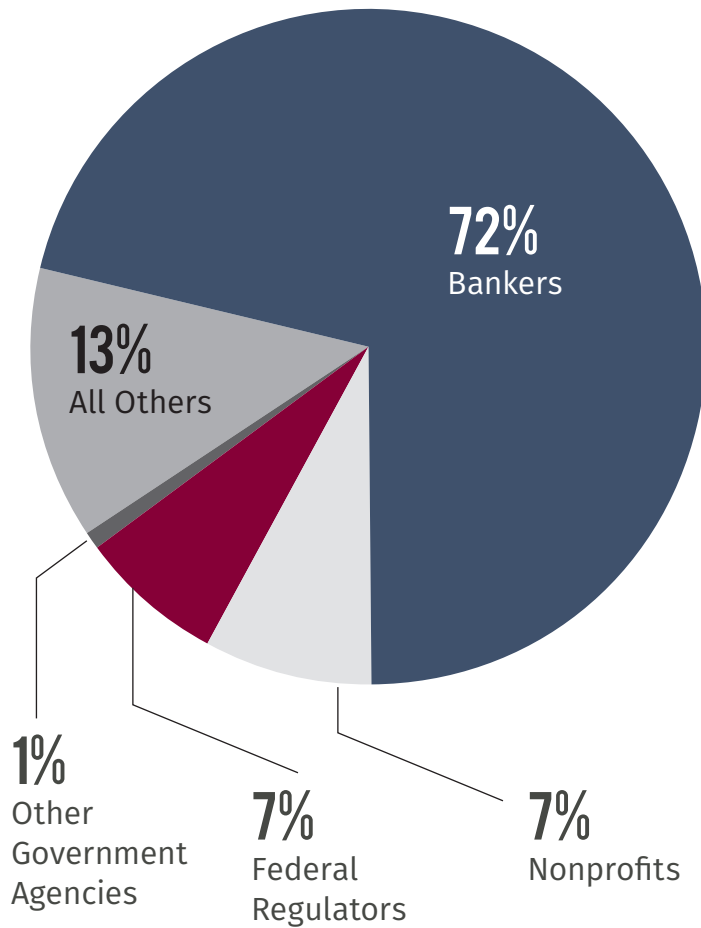


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ESCROW ACCOUNTING RULES: ARE YOU IN COMPLIANCE?

BY RICHELE S. BRADY, FORMER EXAMINER, FEDERAL RESERVE BANK OF SAN FRANCISCO

This article was first published in 2009,¹ when we reviewed common compliance issues related to escrow accounting requirements under Regulation X and discussed practices that institutions could consider to help prevent escrow accounting violations.

Since the article was first published, the Federal Reserve continues to observe escrow accounting issues during compliance examinations, including violations resulting from the use of third-party software to perform escrow calculations, which was not previously discussed. Accordingly, we are refreshing the article to review common escrow violations, discuss ways to mitigate risks when relying on third-party software, and provide an overview of a 2013 amendment to Regulation X that added an escrow accounting requirement for force-placed insurance for residential mortgages.

ESCROW COMPLIANCE ISSUES

Federal Reserve System examination data for state member banks indicate that several of Regulation X's escrow requirements appear among common violations, including the following:

- Understanding escrow accounting methods;
- Preparing escrow disclosure statements;
- Determining escrow deposit amounts;
- Ensuring that annual analyses result in correct account balances; and
- Complying issues resulting from using vendors.

We discuss these issues below.

Escrow Accounting Methods

When establishing and maintaining escrow accounts, financial institutions must do the following:²

- Conduct an escrow account analysis, before establishing an escrow account, to determine the amount the borrower must deposit into the escrow account at inception and the amount of the borrower's periodic payments into the escrow account;³
- Prepare and deliver an initial escrow account statement to the borrower;⁴
- Conduct an escrow account analysis at the completion of each escrow account computation year to determine the borrower's monthly escrow account payments for the next computation year;⁵
- Use the initial and annual escrow account analyses to determine whether a surplus, shortage, or deficiency exists and adjust the account;⁶ and
- Prepare and submit an annual escrow account statement to the borrower.⁷

These escrow tasks must be conducted in accordance with the accounting rules set forth in Section 17 of Regulation X (12 C.F.R. §1024.17). In addition, the regulation limits the amounts that may be held in escrow accounts as well as specific requirements for the contents of the initial and annual statements. Of particular note is the requirement in §1024.17(c) (4) that lenders conduct an aggregate analysis rather than a single-item analysis when performing the account analysis. A single-item analysis accounts for each escrow item separately, while an aggregate analysis considers the account as a whole to compute the sufficiency of escrow account funds. The latter rule has engendered confusion resulting in incorrect amounts being held in escrow accounts.

Initial Escrow Account Analysis and Disclosure

The initial escrow account analysis and disclosure statement set the foundation for the escrow account. Therefore, it is important to consider the following when establishing the account:

- **Initial Escrow Account Analysis.** Compliance with aggregate accounting rules is necessary to accurately calculate the required escrow amounts. Errors can result from a combination of overreliance on automated systems to perform the required calculations and staff not sufficiently versed in the rules. Examples of specific causes include:
- **Initial Escrow Deposits.** The regulation requires the servicer to conduct an escrow account analysis before establishing an escrow account.⁸ Overcharges in the collection of initial escrow deposits often occur because of errors in this initial analysis. The servicer may charge the borrower an amount sufficient to pay charges for the property securing the loan, such as taxes and insurance, which are attributable to the period from the date such payment(s) were last paid until the initial payment date, with the goal of a zero balance projected for the end of the escrow account computation year. However, the servicer may not charge the borrower a cushion that is greater than one-sixth of the estimated total of annual payments from the escrow account.

Other calculation or system entry errors can result in errors in the escrow deposit amounts. Some examples include:

- Using incorrect cushion amounts in excess of the regulatory limitations;
- Collecting excess funds when a property tax installment is paid at settlement;
- Including mortgage insurance (MI) premiums in cushion amounts when MI premiums are paid monthly;
- Using incorrect disbursement dates in projecting activity, such as using the due date rather than the anticipated disbursement dates;
- Failing to itemize separate escrow account items; and
- Rounding adjustments to an even dollar amount.

Annual Escrow Account Analysis and Statement

Just as errors in the initial escrow analysis often cause errors in the initial escrow deposit, errors in the annual account analysis can also lead to incorrect calculations, which often result in incorrect surplus, shortage, or deficiency amounts. Some typical causes include:

- Using incorrect disbursement dates in projecting activity for the next year (e.g., changing the dates of projected disbursements can result in account balance projections that are incorrect);
- Projecting surpluses, shortages, or deficiencies based on incorrect account balances;
- Analyzing an escrow account based on a computation period of more than 12 months;
- Ensuring a thorough review of insurance and/or tax bills is conducted for accurate projection of the disbursement amounts for the upcoming year;
- Maintaining incorrect cushion amounts in excess of regulatory requirements or lower limitations placed in mortgage loan documents; and
- Failing to refund borrower(s) surplus amounts in excess of \$50, where required by §1024.17(f)(2)(i). This does not apply if a payment is not received with 30 days of its due date.⁹

Similarly, incorrect annual escrow statements generally result from missing information, such as not including all the required elements, or from errors in the annual analysis. Examples of information that is often missing or incorrect on the annual statement include:

- The reason the projected low balance (i.e., cushion) was not reached;
- The total amounts paid into and out of the escrow account in the previous year; and
- One or more estimated payments or disbursements missing from the account analysis.

Contents of Annual Escrow Account Statement

Servicers are generally required¹⁰ to provide an annual escrow account statement that includes an account history, reflecting the activity in the escrow account during the escrow account computation year, and a projection of the activity in the account for the next year.¹¹

The account history can be incomplete because of a change in servicers during the life of the loan. When servicing changes occur, it is important for the new servicer to ensure it receives the account history from the prior servicer.

Risks of Using Third-Party Software to Perform Escrow Calculations

Some financial institutions rely on third-party software to perform escrow calculations and create required disclosures. Software vendors, as with any other vendor, must be properly managed to mitigate the risk of violations. In a previous article, *Outlook* discussed this issue:

“Many banks use vendor software to generate consumer disclosures for various loan and deposit products. After amendments to disclosure regulations in the last several years, some vendors failed to update their software, resulting in various errors on disclosure forms. Problems of this nature occur when bank management relies solely on the vendor without conducting its own independent review of disclosure requirements to ensure that the required changes are implemented.”¹²

In addition, financial institutions can periodically verify that the vendor’s software is correctly performing escrow calculations as a control.

Additional Escrow Requirements for Borrowers with Hazard Insurance: §1024.17(k)(5)

In a 2013 rulemaking implementing the Dodd–Frank Wall Street Reform and Consumer Protection Act,¹³ the Consumer Financial Protection Bureau (CFPB) added a force-placed insurance provision applying to borrowers with escrow accounts for payment of hazard insurance.¹⁴ When a borrower is more than 30 days overdue on his or her mortgage payment, the regulation generally prohibits a loan servicer from purchasing force-placed insurance. Instead, unless the servicer is a “small servicer” and meets certain conditions or is “unable to disburse funds” (both of which are discussed next), the servicer must pay the premium for the existing policy from the borrower’s escrow account, even if the escrow account has insufficient funds to cover the premium.¹⁵ If a servicer advances funds under this provision, it may seek repayment from the borrower.¹⁶

Prior to this amendment, servicers could allow a hazard policy to lapse when borrowers were more than 30 days delinquent on their mortgage and replace it with a force-placed insurance policy, which is often more expensive.¹⁷ In the preamble to the final rule, the CFPB explained its concern about this practice:

Force-placed insurance generally provides substantially less coverage for a borrower’s property at a substantially higher premium cost than a borrower-obtained hazard insurance policy, as discussed below in connection with §1024.37. ... When a servicer is receiving bills for the borrower’s hazard insurance in connection with administration of an escrow account, a servicer who elects not to advance to a delinquent borrower’s escrow account to maintain the borrower’s hazard insurance, allowing that insurance to lapse, and then advances a far greater amount to a borrower’s escrow account to obtain a force-placed insurance policy unreasonably harms a borrower. Section 1024.17(k)(5) ... protect[s] borrowers from the unwarranted force-placement of insurance when a servicer does not have a reasonable basis to impose the charge on a borrower. 78 *Fed. Reg.* at 10712

“Unable to Disburse Funds”

The prohibition in Section 1024.17(k)(5) against purchasing force-placed insurance does not apply when a servicer is “unable to disburse funds.”

This occurs when a servicer has a reasonable basis to believe that: 1) the borrower's insurance is being cancelled (or not renewed) for reasons other than nonpayment; or 2) the property is vacant. The BCFP included the carve-out for vacant properties because many hazard insurance policies do not cover losses on vacant properties.

The commentary to the rule provides examples of situations in which a servicer has a reasonable basis to believe that a borrower's insurance is being cancelled for reasons other than nonpayment: (1) when a borrower notifies a servicer that the borrower has cancelled the hazard insurance coverage and the servicer has not received notification of other hazard insurance coverage, (2) when a servicer receives a notification of cancellation or nonrenewal from the borrower's insurance company before payment is due on the borrower's hazard insurance, or (3) when a servicer does not receive a payment notice by the expiration date of the borrower's hazard insurance policy.¹⁸ When any of these conditions are present, a servicer would be able to purchase force-placed insurance under §1024.17(k)(5).

Small Servicer Exception

A limited exception applies to "small servicers," as defined in 12 C.F.R. §1026.41(e)(4)(ii). Small servicers may obtain force-placed insurance, even if the small servicer is able to disburse funds from a borrower's escrow account, provided the cost to the borrower is less than the amount the small servicer would need to disburse to maintain the borrower's existing hazard insurance policy.

Managing Escrow Risks

Institutions offering escrow accounts can manage risks by reviewing escrow accounting systems and disclosures to ensure compliance with the requirements of 12 C.F.R. §1024.17. Analyzing the escrow accounting issues discussed in this article and their causes as you begin this process will help ensure that you do not make the same mistakes. Lenders

holding or servicing loans with escrow accounts may also want to consider the following practices to help manage risks:

- Understand the differences between single-item and aggregate analyses. This distinction is a key factor in complying with the escrow accounting requirements.
- Conduct regular staff training on escrow requirements and include training on the proper usage of the software platform used to generate escrow account disclosures.
- Perform periodic system testing to ensure systems are accurately performing escrow account analyses.
- Review mortgage loan documents for wording regarding cushion limits and ensure that systems comply with either the regulatory or the contractual cushion limitations, whichever are lower.
- Develop policies and procedures for escrow account requirements.
- Conduct periodic compliance reviews and audits that include escrow accounting as well as escrow account statements.
- Periodically verifying that vendor's calculations are correct and that the vendor is implementing regulatory changes to escrow requirements.
- Similarly, following up after a system refresh or software upgrade to ensure parameters were not inadvertently changed resulting in a previously nonexistent issue.

CONCLUSION

The potential impact on consumers and the associated risks to lenders make compliance with the requirements for initial and annual escrow account statements particularly important. While this article provides some practical information to help institutions manage risks, it does not exhaustively address all escrow-related rules, nor all of the complexities of the escrow accounting rules. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator. ■

ENDNOTES

¹ Richele Brady, "[*Escrow Accounting Rules: Are You in Compliance?*](#)" (*Consumer Compliance Outlook*, Second Quarter 2009)

² The escrow requirements appear in 12 C.F.R. §1024.17

³ 12 C.F.R. §1024.17(c)(2)

⁴ 12 C.F.R. §1024.17(c)(2)

⁵ 12 C.F.R. §1024.17(c)(3)

⁶ 12 C.F.R. §1024.17(c)(3)

⁷ 12 C.F.R. §1024.17(1)

⁸ 12 C.F.R. §1024.17(c)(2)

⁹ 12 C.F.R. §1024.17(f)(1)(ii)

¹⁰ 12 C.F.R. §1024.17(i)(1)

¹¹ The escrow statement requirement does not apply if the loan is in default or foreclosure or the borrower has filed bankruptcy. 12 C.F.R. §1024.17(i)(2)

¹² Cathryn Judd and Mark Jennings, "Vendor Risk Management — Compliance Considerations," *Consumer Compliance Outlook*, Fourth Quarter 2012.

¹³ [*78 Fed. Reg. 10696 \(February 14, 2013\)*](#)

¹⁴ *78 Fed. Reg.* at 10714

¹⁵ 12 C.F.R. §1024.17(k)(5)(ii)(B))

¹⁶ 12 C.F.R. §1024.17(k)(5)(ii)(C)

¹⁷ *78 Fed. Reg.* at 10712 ("Force-placed insurance generally provides substantially less coverage for a borrower's property at a substantially higher premium cost than a borrower-obtained hazard insurance policy ...")

¹⁸ Comment 17(k)(5)(ii)(A)-1

REGULATORY CALENDAR

EFFECTIVE DATE†	IMPLEMENTING REGULATION	REGULATORY CHANGE
9/7/18	Reg. C	Interpretive final rule for partial exemptions from the Home Mortgage Disclosure Act (HMDA) under the Economic Growth Regulatory Relief and Consumer Protection Act
4/1/19 (most provisions)	Reg. E	Final rule extending the effective date for the prepaid accounts rule to April 1, 2019
6/1/18	Reg. Z	Final rule allowing creditors to use Closing Disclosure changes in costs to determine if an estimated closing cost was disclosed in good faith
4/19/18	Reg. Z	Final rule revising servicing timing requirements for periodic statements in bankruptcy cases
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 HMDA rules
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

† We have listed the primary effective date. Some final rules have multiple effective dates for different provisions.

* Proposed rules do not have an effective date

NEWS FROM WASHINGTON: REGULATORY UPDATES*

The Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) restores the Protecting Tenants at Foreclosure Act. As explained in CA Letter 18-4, issued on June 22, 2018, by the Federal Reserve Board, Section 304 of the EGRRCPA bill restored the Protecting Tenants at Foreclosure Act of 2009 (PTFA), effective on June 23, 2018. The PTFA, which is self-executing, had expired on December 31, 2014. The law protects tenants from immediate eviction by persons or entities that become owners of residential property through the foreclosure process and extends additional protections for tenants with U.S. Department of Housing and Urban Development Section 8 vouchers.

The Bureau of Consumer Financial Protection (BCFP) amends its “Know Before You Owe” (KBYO) mortgage disclosure rule. On April 26, 2018, the BCFP issued a final rule to amend its KBYO mortgage disclosure rule to address a situation relating to revised estimated closing costs that had led to uncertainty and created implementation challenges in the residential mortgage market.

The BCFP had received industry feedback, regarding the KBYO mortgage disclosure rule, seeking clarification to determine when creditors with a valid justification may pass increased closing costs on to consumers after providing a Closing Disclosure. In some cases, creditors who had already provided a Closing Disclosure to consumers learned of valid closing cost increases (e.g., because of changed circumstance or borrower request) but were unable to issue a revised disclosure because of a timing restriction under the rule regarding when creditors may use a Closing Disclosure to communicate closing cost increases to consumers. In these circumstances, creditors would be prevented from charging consumers for valid closing cost increases, leading in some cases to creditors passing these increased costs on to other consumers by pricing loan products with added margins or even to creditors denying applications on which they could not pass along valid increased closing costs after providing an initial Closing Disclosure. The amendment, which was effective on June 1, 2018, removes this KYBO timing restriction issue by providing that creditors may use a Closing Disclosure to reflect valid changes in closing costs to determine if an estimated closing cost was disclosed in good faith, regardless of when the Closing Disclosure is provided relative to consummation.

The BCFP publishes a snapshot of consumer complaints, focusing on debt collection. On May 31, 2018, the BCFP published its most recent Complaint Snapshot, which contains data from March 2018. The BCFP’s Complaint Snapshot reports are designed to give a high-level overview of consumer complaint trends and update to the Bureau’s Consumer Response Annual Report by providing more recent information. The May 31, 2018, Complaint Snapshot revealed that the BCFP had received about 400,500 consumer complaints regarding debt collection since the agency’s inception in 2010, representing about 27 percent of all consumer complaints received. The report also indicated that credit or consumer reporting was the highest-volume consumer complaint category, with approximately 30,300 consumer complaints (representing about 37 percent of the monthly total). Debt collection (representing about 27 percent of the monthly total) and mortgages (representing about 10 percent of the monthly total) were the second and third highest-volume consumer complaint categories that month, respectively.

In addition to providing information regarding consumer complaint volume by product, the report provides corresponding information regarding consumer complaint volume by state (including Washington, D.C.) of the consumer complainant’s residence.

The Complaint Snapshot also provided granular information about debt collection consumer complaints received by the BCFP since its inception. For example, medical (14 percent), credit card (14 percent), and payday loan debt (9 percent) collection ranked among the highest-volume categories debt collection consumer complaints, with “other debt” (33 percent) and “I don’t know” (23 percent) representing the largest categories.

The Federal Financial Institutions Examination Council (FFIEC) agencies issue revised interagency examination procedures for Regulation X and Regulation Z. On April 19, 2018, the Federal Reserve Board issued CA Letter 18-3, which transmits revised interagency examination procedures for Regulation X (Real Estate Settlement Procedures Act; RESPA) and Regulation Z (Truth in Lending Act; TILA). These procedures were updated by the FFIEC agencies to reflect BCFP mortgage servicing amendments to Regulation X and Regulation Z as well as other Regulation Z amendments, including rules related

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to mortgage lending by small creditors serving rural and underserved areas. The CA letter noted that amendments to Regulation Z regarding the BCFP's TILA-RESPA integrated disclosure rule and prepaid accounts were not incorporated into the revised procedures and will be addressed in a future update.

The FFIEC releases 2017 mortgage lending data. On May 7, 2018, the FFIEC released data on the mortgage lending activity of 5,852 U.S. financial institutions covered by the Home Mortgage Disclosure Act (HMDA) during 2017. The HMDA data are the most comprehensive publicly available information on mortgage market activity. The data both help the public assess whether financial institutions are serving the housing needs of their local communities and inform federal financial regulators' fair lending and consumer compliance examinations. For 2017, the number of reporting institutions declined by 13 percent. This decline resulted, in part, from the BCFP's amendments to Regulation C (HMDA) that raised the threshold for reporting HMDA from originating at least one nonexcluded home purchase or refinance of a home purchase loan in the prior year to originating at least 25 such loans in each of the two preceding calendar years.

The data include:

- Applications, originations, purchases of loans, sales of loans, denials, and other actions related to applications;
- Loan amounts;
- Loan types (conventional, Federal Housing Administration (FHA), Veterans Administration (VA), Rural Housing Service (RHS), or Farm Service Agency (FSA));
- Purposes (home purchase, home improvement, or refinancing);
- Property types (1-4 family, multifamily, or manufactured housing)
- Owner occupancy;
- Preapprovals (home purchase loans only);
- Property locations (metropolitan statistical area (MSA), state, county, and census tract);
- Applicant and coapplicant characteristics (race, ethnicity, sex, and outcome);
- Pricing-related data;
- Type of purchasers;
- Whether a particular loan is subject to the Home Ownership and Equity Protection Act (HOEPA); and
- Whether a particular loan is secured by a first or a subordinate lien, or is unsecured.

The 2017 data revealed that:

- The total number of originated loans decreased by 12.4 percent between 2016 and 2017.
- The share of first-lien owner-occupied home-purchase loans and first-lien owner-occupied refinance loans originated by nondepository, independent mortgage companies increased by 2.8 percent and 3.6 percent, respectively, between 2016 and 2017.
- The government-backed share of first-lien home purchase loans for one- to four-family, site-built, owner-occupied properties decreased by 2.4 percent between 2016 and 2017.
- The incidence of higher-priced loans (defined as loans with an annual percentage rates that exceeds average prime offer rates by at least 1.5 percent for first-liens loans and by at least 3.5 percent for subordinate lien loans) increased 1.4 percent between 2016 and 2017.
- From 2016 to 2017, the share of first-lien home purchase loans for one- to four-family, site-built, owner-occupied properties that were made to low- and moderate-income borrowers rose slightly, by 0.1 percent, and the share of refinance loans to this class of borrowers increased by 6.0 percent.
- Between 2016 and 2017, the share of home purchase loans for one- to four-family properties made to black borrowers rose 0.4 percent; the share made to Hispanic-white borrowers remained unchanged; and the share made to Asian borrowers increased by 0.3 percent.
- From 2016 to 2017, the share of refinance loans made to black borrowers increased by 1.0 percent; the share made to Hispanic-white borrowers increased 0.6 percent; and the share made to Asian borrowers fell by 1.5 percent.
- In 2017, black and Hispanic-white applicants experienced higher denial rates for conventional home purchase loans than non-Hispanic white applicants, while the denial rate for Asian applicants was more comparable with that of non-Hispanic white applicants.

The CFPB summary of the 2017 mortgage lending data is available on the CFPB website. The CFPB provided an interactive tool for searching and analyzing the HMDA data, which is also on the website.

ON THE DOCKET: RECENT FEDERAL COURT OPINIONS*

FAIR CREDIT REPORTING ACT

The Ninth Circuit rejects Fair Credit Reporting Act (FCRA) claims against a consumer reporting agency resulting from a furnisher's error. *Shaw v. Experian Information Solutions, Inc.*, 891 F.3d 749 (9th Cir. 2018). Plaintiffs filed a class-action lawsuit against Experian Information Solutions, Inc. (Experian), a consumer reporting agency, alleging several FCRA violations because of the manner in which it reported its mortgage short sales. While applying for mortgage loans with lenders using Fannie Mae's Desktop Underwriter software, the plaintiffs learned that the software identified their short sales as foreclosures. Fannie Mae imposes a seven-year waiting period for applicants with foreclosures in their credit history but only a two-year waiting period for short sales. The complaint alleged that Experian's practice of erroneously coding short sales as foreclosures violated FCRA provisions requiring consumer reporting agencies 1) to use reasonable procedures when preparing consumer reports to assure maximum possible accuracy (accuracy claim), 15 U.S.C. §1681e(b); 2) to accurately disclose information in the credit reports provided to consumers (disclosure claim), 15 U.S.C. §1681g; and 3) to conduct a reasonable reinvestigation of information in a consumer's credit file if a consumer disputes it (reinvestigation claim), 15 U.S.C. §1681i.

To prevail on the accuracy and reinvestigation claims, the Ninth Circuit held that the plaintiffs must establish inaccurate reporting, which the court defined as information that is "patently incorrect" or "misleading in such a way and to such an extent that it can be expected to adversely affect credit decisions." Because Experian coded the short sales with a code (9-68) that corresponded to short sales, the court found that the information was accurate. Similarly, the court found that Experian's coding was not misleading because the problems arose from how Fannie Mae treated the data Experian provided, and not how Experian reported it, stating "[t]he FCRA does not suggest that Experian should be liable for the misconduct of one of [its] 15,000 subscribers, even if that subscriber is as well known as Fannie Mae." Regarding the plaintiffs' claim that Experian did not disclose the information properly in the plaintiffs' credit reports, Experian listed the plaintiffs' short sales as "account[s] legally paid in full for less than full balance," which the court deemed accurate. Accordingly, the court affirmed the district court's summary judgment in favor of Experian.

FAIR CREDIT REPORTING ACT

The Ninth Circuit rejects the FCRA claim that displaying a debit card expiration date on a printed receipt was traceable to subsequent fraudulent activity on the card. *Daniel v. National Park Service*, 891 F.3d 762 (9th Cir. 2018). The FCRA prohibits any person who accepts credit or debit cards from printing the expiration date or more than the last five digits of the card number on any receipt provided to the cardholder at the point of sale. In *Daniel*, the plaintiff filed a class-action lawsuit against the National Park Service alleging it violated the FCRA by printing her debit card's expiration date from her receipt after she purchased an entrance pass to Yellowstone National Park. The plaintiff claimed that her debit card was used fraudulently thereafter and that she suffered damages because of her stolen identity. She also alleged that this was partially a result of the National Park Service's inclusion of the card's expiration date on her receipt.

The district court dismissed the lawsuit. On appeal, the Ninth Circuit affirmed, finding that the plaintiff failed to establish that she had legal standing under the Supreme Court's decision in *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540, 1547 (2016). Under *Spokeo*, a plaintiff must establish an injury "that is fairly traceable to the challenged conduct." The plaintiff failed to allege that fraudulent use of her debit card was "fairly traceable" to the National Park Service's issuance of the receipt with the card expiration date. The court held that merely asserting that the theft occurred at an unspecified time after the debit card transaction was not sufficient to satisfy the "fairly traceable" requirement. Further, the Ninth Circuit determined that the FCRA does not waive the federal government's sovereign immunity, so the National Park Service was immune from suit.

FAIR DEBT COLLECTION PRACTICES ACT

The Seventh Circuit rules that a debt collector who was told that alleged debt amounts were "not accurate" violated the Fair Debt Collection Practices Act (FDCPA) when reporting the debt to consumer reporting agencies without indicating they were disputed. *Evans v. Portfolio Recovery Associates, LLC*, 889 F.3d 337 (7th Cir. 2018).

Under the FDCPA, when debt collectors report a consumer's debt to consumer reporting agencies that they know or should know is disputed, they must indicate the debt is disputed. In *Evans*, a debt collector sought to collect from four separate consumers who had defaulted on their credit card debts. Over 30 days after receiving the debt collector's validation notices describing the debt amounts, the consumers sent letters through counsel to the debt collection agency, each stating that "the amount reported is not

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accurate.” The debt collector nevertheless communicated each consumer’s debt information to the consumer reporting agencies without noting that the debt was disputed.

The Seventh Circuit determined that the consumers had been harmed because of the risk of damage to their credit scores and accordingly had standing to bring suit against the debt collection agency. The court held that the debt collector violated the FDCPA because it did not report that the debts were disputed. The court explained that, regardless of whether their disputes were valid or reasonable, it was sufficient that the plaintiffs simply had called into question the amount owed (even though they did not use the word “dispute” or send the letters to the agency’s special disputes department). The court also explained that it was irrelevant that the consumers’ letters were sent outside of the 30-day period under Section 1692g of the FDCPA, which specifies that consumers can submit written disputes to trigger debt verification procedures. The requirement that a debt collector notify the consumer reporting agencies that a consumer disputes the debt arises under Section 1692e(8), which does not impose a time limit. Finally, the court addressed an issue of first impression for the Seventh Circuit in determining that a debt collector’s failure to inform a credit reporting agency of the disputed nature of a debt will always have a material influence on the debtor and thus is an actionable violation under the FDCPA.

REGULATION Z — TRUTH IN LENDING ACT (TILA)

The Third Circuit rules that when a disputed credit card transaction is removed from a billing statement and subsequently reinstated, the cardholder’s 60-day deadline for disputing the charge begins on the date of the billing statement in which the charge is reinstated. *Krieger v. Bank of America, N.A.*, 890 F.3d 429 (3d Cir. 2018). The plaintiff disputed a charge on his credit card statement, and the issuer agreed to remove it. But the card issuer later reinstated the charge on a subsequent statement and refused to remove it because the issuer stated that it had received evidence that the transaction was “valid.” The district court ruled in favor of the card issuer, finding that the consumer was required to dispute the charge in writing within 60 days of the first statement in which it appeared, rather than 60 days from the statement with the reinstated charge. The district court also determined that the Truth in Lending Act (TILA) provision that limits a cardholder’s liability to \$50 for unauthorized use of a credit card does not provide a cardholder with a right to be reimbursed.

On appeal, the Third Circuit reversed both rulings. Regarding the timeliness of the dispute, the Third Circuit held that requiring the consumer to dispute the charge after it was removed and before the issuer reinstated it would be “nonsensical” because it would require consumers to file a written notice of a billing statement error, even when the consumer reasonably believes that the card issuer already remedied the error. Instead, in cases in which a disputed charge is removed and reinstated, the 60-day period in which a consumer must file a written dispute begins when the consumer receives the first billing statement that reinstates the charge. The Third Circuit also found that the TILA provision on private right of action provides for a right to recover “actual damages,” to which the cardholder in this case was entitled.

REGULATION X — REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

The Eighth Circuit agrees with the district court that when a mortgage loan servicer responds to a borrower’s qualified written request with an investigation and explanation, that investigation must be reasonably thorough. *Wirtz v. Specialized Loan Servicing, LLC*, 886 F.3d 713 (2018). The Real Estate Settlement Procedures Act (RESPA) gives mortgage loan servicers three options for appropriately responding to borrowers’ qualified written requests. These options include that a servicer may, “after conducting an investigation,” provide the borrower with a statement explaining why the servicer believes the borrower’s account is correct, or “after conducting an investigation,” provide the information requested by the borrower or an explanation of why the requested information is unavailable. If a mortgage loan servicer fails to comply with its duties to respond to a qualified written request, the borrower is entitled to actual damages stemming from the failure as well as statutory damages up to \$2,000 and costs and attorney’s fees.

In *Wirtz v. Specialized Loan Servicing*, the Eighth Circuit ruled that any investigation conducted in response to a borrowers’ qualified written request must be reasonably thorough for it to satisfy the RESPA requirements. The court determined that, because the mortgage loan servicer failed to obtain and review the borrower’s loan payment history upon request from the borrower, the loan servicer had not conducted a reasonable investigation. However, the court ultimately reversed the district court’s award of damages finding that the borrower did not establish an essential element of his RESPA claim because he did not show that he suffered any actual damages as a result of the mortgage loan servicer’s failure to meet the qualified written request requirements.

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CALENDAR OF EVENTS 2019

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| February 10-13 | ABA National Conference for Community Bankers
Hilton San Diego Bayfront, San Diego, CA |
| June 9-12 | ABA Regulatory Compliance Conference
Hyatt Regency, New Orleans, LA |
| June 19-21 | Policy Summit 2019: Connecting People & Places to Opportunity
Federal Reserve Bank of Cleveland, Cleveland, OH |

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