

CONSUMER COMPLIANCE OUTLOOK®

A FEDERAL RESERVE SYSTEM PUBLICATION FOCUSING ON CONSUMER COMPLIANCE TOPICS

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UPDATE

The articles for this issue were prepared before the COVID-19 pandemic emerged, so we were unable to include COVID-19 content. The next issue of *Outlook* will be devoted to COVID-19 to help financial institutions adhere to consumer protection laws and regulations while helping their customers during this unprecedented health and economic crisis. In the meantime, please visit the Board's COVID-19 resource page at:

<https://www.federalreserve.gov/covid-19.htm>.

A VIEW FROM THE FIELD: COMMONLY CITED VIOLATIONS

BY KAMILAH EXUM, COMMUNITY, REGIONAL, AND SPECIALTY BANK EXAMINER,
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During outreach events with bankers, Federal Reserve System staff are often asked about the most commonly cited compliance violations. This information can alert bankers to potential risks at their own institutions. To generate awareness in the areas in which examiners routinely find violations, *Outlook* published an article in 2012 titled, “View from the Field: Commonly Cited Compliance Violations in 2011.” Because this is one of *Outlook*’s most popular articles and because it was published eight years ago, we are refreshing it with more recent examination data.

Based on a review of all of the Federal Reserve’s consumer compliance examinations conducted since the 2012 article was published, the most common violations are:

- Regulation B’s spousal signature requirements;
- Regulation H’s flood insurance purchase and force-placement requirements;
- Regulation Z’s finance charge requirements; and
- Fair Credit Reporting Act’s adverse action notice requirement.

Some of these violations, such as force-placed flood insurance, were discussed in the 2012 *Outlook* article. But examiners also found some new frequent violations, such as the flood insurance purchase requirements. This article discusses the top violations, the associated regulatory requirements, and the steps financial institutions may undertake to mitigate risks.

REGULATION B — EQUAL CREDIT OPPORTUNITY

The Equal Credit Opportunity Act (ECOA), as implemented by Regulation B, makes it unlawful for creditors to discriminate on a prohibited basis in any aspect of a credit transaction, including sex and marital status: 15 U.S.C. §1691(a); 12 C.F.R. §§1002.2(z), 4(a). In enacting the ECOA, Congress sought “to insure that the various financial institutions and other firms engaged in the extensions of credit exercise their responsibility to make credit available with fairness, impartiality, and *without discrimination on the basis of sex or marital status*.”¹ Violations of the spousal signature requirements continue to be a common violation.

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PREPARE YOUR COMMUNITY BANK TO SURF THE SILVER TSUNAMI¹

BY JEANNE RENTEZELAS, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, AND LARRY SANTUCCI, ADVISOR AND RESEARCH FELLOW, CONSUMER FINANCE INSTITUTE, FEDERAL RESERVE BANK OF PHILADELPHIA

If you are reading this article, there's a good chance you've noticed that your customer base is aging. In 2011, the first of the baby boomers turned 65. Since then, about 10,000 more have reached 65 every day, and this pace will continue until 2029.² This silver tsunami of retirees will challenge conventional banking norms, changing the way community banks and other financial institutions serve their customers. This article discusses some of the changes banks may consider implementing and how community banks are uniquely positioned to safeguard the financial health of the U.S. senior population.

OLDER ADULTS' FINANCIAL NEEDS

An aging population has different financial needs than a younger one. Older customers may be more likely to visit a bank branch than younger ones and thus value the convenience of local bank branches. Some older adults will experience physical limitations that may make it more difficult for them to climb stairs, stand in long lines, or read small print. And many will experience *diminished financial capacity*, a degradation of their ability to manage their money and make sound financial decisions. Diminished financial capacity is caused by a loss of cognitive function, typically due to the onset of Alzheimer's disease or other diseases causing dementia. People with diminished financial capacity can have trouble paying their bills and remembering their account balances and are more likely to be victimized by fraud schemes or financially exploited by friends or family members. The financial consequences can be catastrophic; the average financial exploitation victim loses \$120,000 per exploitative event.³ The value at risk is staggering. The Employee Benefits Research Institute estimates that baby boomers and current retirees hold almost 70 percent of all U.S. financial assets, or about \$66 trillion.⁴

A ROLE FOR COMMUNITY BANKS

Community banks have local roots that run deep. The relationships bankers have with their customers can go back generations. Simply put, community banks know their customers, and their customers know them. With such long-standing relationships, community banks are uniquely positioned to notice changes in a customer's behavior, interactions with family and friends, or banking patterns. These relationships also help to align the success of community banks to the continued financial success of their customers. Taking action to protect against elder financial abuse preserves those long-standing relationships and helps build trusting relationships with the adult children who will one day be retirees themselves. On the other hand, not taking action can lead to higher operating expenses and fraud losses, lost business, and reputational damage.

Several community banks have been at the forefront of the fight against elder financial fraud and exploitation. A 2016 AARP white paper recognized Bank of American Fork's work with the Utah Division of Aging and Adult Services to implement a five-step strategy to help prevent financial exploitation

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and improve seniors' banking experiences.⁵ In 2016, the American Bankers Association (ABA) Foundation presented Montecito Bank & Trust, a locally owned California community bank, with a Community Commitment Award for its work to protect older Americans from financial abuse.⁶ The ABA Foundation has also honored Bank of the Rockies, National Association, for its programs promoting elder fraud prevention and awareness.⁷

SIX SOUND PRACTICES FINANCIAL INSTITUTIONS CAN CONSIDER TO ADDRESS ELDER FINANCIAL ABUSE

Federal agencies and other organizations have offered guidance to assist the financial services community in its efforts to prevent elder financial abuse and to intervene when it occurs (see Resources for Preventing Elder Financial Abuse on page 5). In a recent Philadelphia Federal Reserve discussion paper,⁸ the authors reviewed information provided by these and other sources and created a list of six considerations for financial institutions to help detect and prevent elder financial abuse.

1. Train frontline staff to recognize and react to signs of diminished financial capacity, elder financial fraud, and exploitation.

The signs of diminished financial capacity, elder financial fraud, and exploitation are often visible to a trained eye. Frontline staff, branch managers, call center employees, and others can be trained to recognize the signs of existing or imminent financial trouble. Effective training programs can help staff identify red flags, provide examples of elder fraud scams, explain what actions bank employees can take once suspicious activity is detected, and clearly delineate the roles and responsibilities of management and staff.

Training need not be costly. Financial institutions have access to a variety of free or low-cost training, including a program launched by the AARP in May 2018, the North American Securities Administrators Association's (NASAA) SeniorSafe Training program, and the Senior Investor Protection Toolkit from the Securities Industry and Financial Markets Association (SIFMA).⁹

Scammers are always coming up with new scams and twists on old ones. To keep up with the latest scams, banks can leverage the Federal Trade Commission, the National Consumers League, and the AARP, all of which track scams and post alerts to their websites.¹⁰ The AARP's Fraud Watch Network provides access to information about identity theft, investment fraud, and the latest scams, while its Fraud Watch Helpline fields calls from consumers seeking assistance and reporting new scams. Community bank staff who are alert to the latest scams will be better positioned to detect and prevent fraud and exploitation, as well as to pass along valuable information to their bank customers.

EDITOR'S NOTE

In spring 2017, *Outlook* published an article titled "Combating Elder Financial Abuse." The article cites data on this issue, reviews regulatory guidance on information that financial institutions can permissibly share with law enforcement agencies, and discusses sound practices to help institutions respond to this problem.

Elder financial abuse remains a challenging problem. According to the Consumer Financial Protection Bureau, the number of suspicious activity reports filed for elder financial exploitation quadrupled from 1,300 per month in April 2013, to about 5,300 per month in December 2017. The editors therefore decided to publish another article on this topic that provides six suggestions for financial institutions to help address this problem.

In addition, Congress enacted the Economic Growth Regulatory Relief and Consumer Protection Act in 2018. This law includes the Senior Safe Act (the act) (12 U.S.C. §3423), which provides a safe harbor to financial institutions and certain staff against legal liability for reporting suspected elder financial abuse to authorities if certain requirements are satisfied. See the accompanying Compliance Spotlight on page 14 for a summary of the act.

2. Repurpose existing bank systems to detect unusual transactions.

While many of today's older adults prefer face-to-face transactions with a bank teller, automated surveillance tools may also be considered as Internet-savvy baby boomers age into retirement.¹¹ Continuous monitoring and analysis of transaction data can help financial institutions identify, flag, and address unusual activity. For example, sudden activity on a rarely used account, transaction patterns inconsistent with that of an older consumer, and large daily ATM withdrawals are potential signs of financial exploitation.¹² Banks may be able to repurpose existing business systems, such as anti-money-laundering (AML) and fraud detection software, to monitor customers' day-to-day transactions for abnormalities. AML software typically contains an integrated transaction-monitoring module that can be repurposed to detect elder fraud and abuse.

3. Provide account holders and their financial caregivers with tools to help them detect suspicious account activity.

By providing tools such as read-only access to online banking, convenience accounts (a special type of joint account), and suspicious activity alerts, banks can empower older customers and their financial caregivers to help monitor

the older person's accounts for signs of fraudulent or unusual activity. Read-only account access requires one or more trusted people to have access to view the older person's online banking account via a separate set of credentials (username and password). The trusted person cannot authorize any transactions but will be able to see account activity. Joint accounts or convenience accounts should be encouraged only when the older adult has confidence that the trusted party being added to the account will always act in the interest of the original account holder. If there is any doubt about whether the additional party is sufficiently trustworthy, these account types may not be viable options.¹³ Account alerts can be especially helpful for account holders

BANKS CAN TRAIN CUSTOMER-FACING STAFF TO RECOGNIZE POTENTIAL POWER OF ATTORNEY ABUSE. . . .

suffering from cognitive impairment, as they enable financial caregivers to spot transactions authorized by the account holder that may not be in the person's financial interest.

4. Prepare a trusted contact form and develop policies governing when an employee may reach out to the person listed on the form.

When bank employees believe an older person is the victim of fraud, they might not be able to convince the person to cancel a transaction. This often occurs when the older adult is the victim of a scam, such as:

- the Grandparent Scam, in which a scammer calls a grandparent, pretending to be a grandchild in trouble and in need of money;¹⁴
- the Lottery Scam, in which an older person receives an email, phone call, or letter saying that he or she has won the lottery but must pay a tax or fee, often by prepaid card, before receiving the winnings;¹⁵ and
- the Romance Scam, in which a scammer establishes a relationship with someone to gain his or her trust, quickly proposing marriage before ever meeting in person. Eventually, the scammer begins asking for money.¹⁶

In those situations, the bank can reach out to someone the older adult trusts to try to convince the older adult to reconsider sending money to the scammer. For that to happen, the bank must have both the trusted person's contact information as well as the account holder's consent to contact that person. A financial institution that does

not have a trusted contact on file for a particular account may have to allow a suspicious transaction to go through. Banks can make a reasonable effort to obtain the name and contact information for a trusted contact when opening a new account or when updating the customer's account information. Although consumers may want to keep their financial information completely private, doing so may become an obstacle in preventing or mitigating financial harm. When reaching out to the trusted contact, consistent with relevant financial privacy laws, bank staff members may be limited in what they may disclose. The information provided to the trusted contact may need to be as vague as "bank staff has reason to believe that the account holder may be the current target of a scam — you might want to speak to the account holder to see if he or she will give details to aid you in providing helpful advice."

5. Institute policies to prevent an agent under a power of attorney from abusing the access to an older person's finances.

A durable power of attorney is a valuable tool for a person planning for the possibility of cognitive impairment. Establishing this power of attorney ensures that someone else can make decisions for an older adult who is unable to make independent financial decisions. However, even the most well-intentioned power of attorney can turn into a license to steal.¹⁷ In certain situations, abusing a power of attorney may not be easily pursued as a crime, such as in situations in which the agent makes gifts of cash or other assets to him- or herself or someone else without specific authorization from the principal or when the agent engages in transactions that go against the principal's unwritten, but known, wishes.¹⁸ Banks can train customer-facing staff to recognize the potential power of attorney abuse and, when it is detected, to escalate the issue to a manager specifically trained to address the issue.

In addition to being alert to possible power of attorney abuse, banks also need to be aware that their employees might refuse to honor a valid power of attorney for reasons other than suspected fraud or abuse. The CFPB reports that financial institutions sometimes refuse to accept a power of attorney that is valid under state law.¹⁹ The financial institution may object because its own power of attorney form was not used, which is typically not a valid basis for objection under state law. Banks and other financial institutions may want to ensure that their employees are well trained both to honor a valid power of attorney and to detect signs of exploitation so that the purposes of the power of attorney are properly effectuated.

6. Report suspected financial abuse by a caregiver, trustee, guardian, or attorney-in-fact to local law enforcement and adult protective services (APS).²⁰

Many older adults have family members or other trusted persons they can rely upon to assist with banking and investment decisions. Sometimes, what begins as an honest



caregiving effort can turn into a financially exploitative situation. When older adults are financially exploited, perpetrators are usually family members or someone they trust.²¹ As mentioned previously, a single case of financial exploitation can cause tens of thousands of dollars of lost savings. Early intervention by law enforcement and APS is critical in preventing a perpetrator from accessing savings. Unfortunately, the laws governing financial institutions' reporting obligations are murky and vary from state to state.

Some financial institutions have a policy of reporting all cases of suspected elder abuse to APS, whether mandated by state law or not.²² Banks that do not report suspected elder abuse provide opportunities for the perpetrator to steal additional savings. This may also affect the victim's ability to recover any of the stolen funds through the legal system, since it provides the perpetrator with more time to spend the stolen funds.²³ After following the bank's internal policies and procedures for potential unusual activity, a sound practice is to report the suspected elder abuse to APS regardless of what is legally required.

CONCLUDING THOUGHTS

Everyone can do more to detect, respond to, and prevent financial losses for older consumers. Changes in cognitive abilities continue to cost older Americans billions of dollars each year.²⁴ This is money they simply cannot afford to lose: A single financial exploitation event can result in a loss of hundreds of thousands of dollars and can have adverse consequences for physical and functional health.²⁵

Distinguished by their close ties to the communities and customers they serve, community banks can leverage those personal relationships to detect and prevent financial losses resulting from diminished financial capacity, fraud, and exploitation, and serve as a model for the financial services industry to follow. ■

Resources for Preventing Elder Financial Abuse

We have compiled a list of resources from various organizations providing more information on preventing elder financial abuse. Links to each of these special reports, guides, and toolkits are available on the *Consumer Compliance Outlook* site at consumercomplianceoutlook.org.

Consumer Financial Protection Bureau (CFPB), "Recommendations and Report for Financial Institutions on Preventing and Responding to Elder Financial Exploitation," March 2016.

The full report was published in March 2016.

CFPB, "Advisory for Financial Institutions on Preventing and Responding to Elder Financial Exploitation," March 2016.

This is a companion advisory to the CFPB's full report, which was published in March 2016.

CFPB and Federal Deposit Insurance Corporation, "Money Smart for Older Adults Resource Guide," September 2018.

The Federal Reserve System, "CA letter 13-14: Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults," September 2013.

National Community Reinvestment Coalition, "Guide to Age-Friendly Banking Products, Services, Protections, and Resources for Older Adults," 2011.

Securities Industry and Financial Markets Association, "Senior Investor Protection Toolkit."

ENDNOTES*

- 1 This article is also being published in *Community Banking Connections*, a Federal Reserve System publication that focuses on community banks.
- 2 Russell Heimlich, *Baby Boomers Retire*, Pew Research Center, December 29, 2010.
- 3 Jilene Gunther, “BankSafe Safeguards Against Exploitation,” AARP Public Policy Institute.
- 4 Larry Santucci, “Aging, Cognition, and Financial Health: Building a Robust System for Older Americans,” Conference Summary, Federal Reserve Bank of Philadelphia, September 2019.
- 5 Jilene Gunther, “Preventing Exploitation: Five Banks Leading the Fight,” AARP Public Policy Institute, April 2016.
- 6 Monica C. Meinert, “Six Banks to Receive Community Commitment Awards,” *ABA Banking Journal*, September 22, 2016.
- 7 ABA Foundation, “2017 ABA Foundation Community Commitment Awards.”
- 8 Jeanne Rentzelas and Larry Santucci, “Combining Forces to Combat Elder Financial Victimization: How Consumers Can Avoid the Pitfalls of Cognitive Aging and What They Should Be Asking Their Financial Institutions,” Federal Reserve Bank of Philadelphia Payment Cards Center Discussion Paper, June 2018.
- 9 The NASAA’s SeniorSafe Training program was unveiled in March 2016 to all members of the banking and securities industries. As part of its free Senior Investor Protection Toolkit, SIFMA offers resources to help brokers and financial advisers identify the signs of fraud and financial exploitation. Beginning in May 2018, the AARP launched a program for its newly developed BankSafe training platform, aimed at teaching frontline staff, supervisors, and compliance officers how to detect and prevent exploitation.
- 10 See the Federal Trade Commission Consumer Information Scam Alerts; Fraud!org, a project of the National Consumers League; and AARP’s Money: Scams & Fraud.
- 11 Susan Burhouse, Karyen Chu, Ryan Goodstein, Joyce Northwood, Yazmin Osaki, and Dhruv Sharma, “2013 FDIC National Survey of Unbanked and Underbanked Households,” Federal Deposit Insurance Corporation, October 2014. The authors found that 54.7 percent of households aged 65 or older primarily used bank tellers to access their accounts.
- 12 See “How Financial Institutions Can Prevent Elder Financial Exploitation,” Narmi Inc., 2018.
- 13 Adding more than one trusted person to the joint or convenience account arrangement may mitigate the risk of one person acting unilaterally, assuming that collusion among the trusted persons added is unlikely.
- 14 National Consumers League, “Fraud Against Older Adults: Grandparent Scams,” fraud.org, 2018.
- 15 “Sweepstakes and Lottery Scams,” AARP.org, accessed November 7, 2019.
- 16 “Romance Scams: Online Imposters Break Hearts and Bank Accounts,” FBI.gov, February 13, 2017.
- 17 Lori A. Stiegel and Ellen V. Klem, “Power of Attorney Abuse: What States Can Do About It,” AARP Public Policy Institute, Research Report, November 2008.
- 18 Linda S. Whitton, “National Durable Power of Attorney Survey Results and Analysis,” National Conference of Commissioners on Uniform State Laws, October 29, 2002.
- 19 “Recommendations and Report for Financial Institutions on Preventing and Responding to Elder Financial Exploitation,” Consumer Financial Protection Bureau, March 2016.
- 20 An attorney-in-fact is an agent authorized to act on behalf of another person but not necessarily authorized to practice law. See Legal Information Institute, “Attorney-in-Fact,” accessed November 7, 2019.
- 21 National Adult Protective Services Association, “Get Informed: Elder Financial Exploitation,” accessed November 7, 2019.
- 22 Ronald C. Long, “Elder Financial Abuse,” *Elder Abuse and Its Prevention: Forum on Global Violence Prevention*. Washington, D.C.: National Academies Press (2014).
- 23 Sandra L. Hughes, “Can Bank Tellers Tell? Legal Issues Related to Bank Reporting of Suspected Elder Financial Abuse,” American Bar Association, 2003.
- 24 MetLife, “The MetLife Study of Elder Financial Abuse: Crimes of Occasion, Desperation, and Predation Against America’s Elders,” June 2011. This study estimates that older victims lose at least \$2.9 billion annually from financial abuse.
- 25 See Jaclyn S. Wong and Linda J. Waite, “Elder Mistreatment Predicts Later Physical and Psychological Health: Results from a National Longitudinal Study,” *Journal of Elder Abuse and Neglect*, 2017, 29:1, pp. 15–42. True Link Financial (2015) estimates that 954,000 seniors are skipping meals as a result of financial losses from abuse.
- * Note: The links to the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at www.consumercomplianceoutlook.org.

A VIEW FROM THE FIELD: COMMONLY CITED VIOLATIONS

Spousal Signatures —12 C.F.R. §1002.7(d)

Regulatory Requirements

Section 7(d) of Regulation B generally provides that a creditor shall not require the signature of an applicant's spouse who is not a joint applicant on any credit instrument if the applicant qualifies on his or her own, except in certain circumstances, including:

- When the spouse's signature is necessary as a matter of state law to provide a secured creditor access to collateral in the event of default, or to give an unsecured creditor access to property otherwise relied upon in the event of death or default; or
- When the spouse is providing credit support because the primary applicant does not meet the creditor's lending standards. However, when an additional party is needed, a creditor may not require that it be a spouse.

In the case of a joint application, the commentary to the regulation also states that a "person's intent to be a joint applicant must be evidenced at the time of application."²

Common Violations

Commercial and agricultural loans. In some cases, examiners have observed that violations occurred because a creditor had strong controls for consumer loans but not for commercial and agricultural loans. It is important to recognize that Regulation B applies to consumer *and* commercial credit because the definition of "credit" in Section 2(j) is not limited to consumer credit.³

State law. Some creditors have impermissibly required spousal signatures on credit instruments out of an "abundance of caution." A creditor cannot require a spouse's signature on a credit instrument unless one of the regulation's exceptions applies, and "abundance of caution" is not one of them. If a creditor believes a spouse's signature on an instrument is necessary under state law, the commentary to Regulation B states that the creditor should support and document this determination by "a thorough review of pertinent [state] statutory and decisional law or an opinion of the state attorney general."⁴

Evidence of joint intent. To satisfy the intent requirement for joint applications, some creditors rely on a signed joint financial statement obtained at application as evidence of the applicants' intent to apply for credit jointly. The commentary to Regulation B clarifies that "[t]he method used to establish intent must be distinct from the means used by individuals to affirm the accuracy of information. *For example, signatures on a joint financial statement affirming the veracity of information are not sufficient to establish intent to apply for joint credit.*"⁵ (Emphasis added.)

Compliance Risk Management

Lenders can take several steps to help mitigate the risk of a potential Regulation B spousal signature violation:

- *Policies and procedures.* At the time of application, lenders can document that spouses intended to apply for credit jointly by using the Regulation B model application form, which specifically contains a field to show joint intent: **See Figure 1.**

Figure 1

CREDIT APPLICATION

IMPORTANT: Read these Directions before completing this Application.

Check
Appropriate
Box

☐ If you are applying for an individual account in your own name and are relying on your own income or assets and not the income or assets of another person as the basis for repayment of the credit requested, complete only Sections A and D.

☐ If you are applying for a joint account or an account that you and another person will use, complete all Sections, providing information in B about the joint applicant or user.

☐ We intend to apply for joint credit.

 Applicant

 Co-Applicant

- *Training.* Lenders can provide regular training to ensure the staff understands Regulation B's spousal signature requirements. Training in this particular aspect of Regulation B compliance is sometimes overlooked, especially when the staff has many years of experience or when lenders concentrate in commercial or agricultural lending.
- *Risk monitoring and internal controls.* Finally, lenders can conduct risk assessments, compliance reviews, and/or audits that include transaction testing for compliance with Section (7)(d). Where findings occur, financial institutions can consider working to understand the specific root causes and implementing practices to address the causes.

Regulation H — Flood Insurance

Under the Flood Disaster Protection Act of 1973 (FDPA), regulated lending institutions cannot extend real estate secured loans in areas at high risk for floods unless the borrower obtains flood insurance. See 42 U.S.C. §4012a(b)(1) and 12 C.F.R. §208.25(c)(1).

In addition, if a lender determines after origination that a covered loan has no insurance or insufficient insurance, the lender is required to notify the borrower and force-place insurance if the borrower fails to obtain sufficient flood insurance in a timely manner. See 42 U.S.C. §4012a(e) and 12 C.F.R. §208.25(g)(1).

Congress enacted this law because it was “acutely aware of the national need for a reliable and comprehensive flood insurance program to provide adequate indemnification for the loss of property and the disastrous personal loss suffered by victims of recurring flood disasters throughout the nation. ... Floods have been, and continue to be, one of the most destructive national hazards facing the people of the United States.”⁶

Purchase of Flood Insurance — 12 C.F.R. §208.25(c)(1)

Regulatory requirements

Section 208.25(c)(1) states:

A [lender] shall not make, increase, extend, or renew any designated loan [a loan secured by property in a special flood hazard area located in a National Flood Insurance Program (NFIP) participating community] unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan. The amount of insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act.

Flood insurance coverage under the Act is limited to the building or mobile home and any personal property that secures a loan and not the land itself.

Common Violations

Examinations showed that this violation commonly occurred because the issuing bank did not have adequate controls, policies, and procedures for ensuring adequate flood insurance was in place prior to loan closing. For example, some lenders required flood insurance prior to loan consummation but did not have sufficient controls for ensuring coverage the proper amount was obtained.

Examiners also found violations occurred because lending staff did not understand the regulatory requirements and issues with third-party flood insurance vendors. In 2019, *Outlook* published an article “Vendor Management Considerations for Flood Insurance Requirements,” addressing vendor issues.⁷

Compliance Risk Management

To facilitate compliance with 12 C.F.R. §208.25(c)(1), a lender might consider integrating some or all of the following steps in its compliance management systems (CMS) to mitigate risk:

- *Checklists.* One practice is to use checklists during loan origination that address the proper timing of the Standard Flood Hazard Determination (SFHD) form and the purchase of adequate flood insurance where necessary.⁸ This checklist could contain a section in which the loan processor or lender can indicate that the SFHD has been received and where the processor can indicate whether flood insurance is required. The checklist also could contain the different minimum amounts of insurance, based on collateral type, and include a space for the loan processor or lender to write in the loan amount. These latter additions could make it easier for the processor to determine the correct amount of flood insurance required.
- *Centralization.* The degree to which an institution centralizes its compliance operations affects compliance risk. “Centralized activities may help limit risk by consolidating knowledge and processes in fewer locations. When centralized operations are handled effectively, the opportunity for error may decrease as a result.” Conversely, decentralizing compliance operations can increase compliance risk.⁹
- *Secondary review.* CMS also can be strengthened by implementing a secondary review to ensure all loans secured by a property located in a standard flood hazard area close with adequate flood insurance in place.

Force Placement — 12 C.F.R. §208.25(g)

Regulatory Requirements

The regulation (12 C.F.R. §208.25(g)) states that if at any time during the term of the loan a lender or its servicer determines that the collateral has less flood insurance coverage than is required by the federal agencies' implementing regulations, it is required to notify the borrower to obtain the required insurance. If the borrower has not purchased the necessary flood insurance within 45 days after the notice was sent, the lender must purchase insurance on the borrower's behalf.

A lender may comply with the force-placement requirement by purchasing a National Flood Insurance Policy or an appropriate private flood insurance policy in the amount required by the implementing regulations.

Common Violations

Examiners observed several common circumstances resulting in force-placement violations, including:

- FEMA remapped a property into a SFHA and the life-of-loan vendor failed to flag this; or the vendor flagged it and notified the bank, but the lender failed to timely act upon this change.
- The borrower let a policy lapse or reduced the amount of coverage below the required amount, and the lender failed to verify the policy was renewed in the correct amount.
- The lender discovered a violation but failed to send out the 45-day notice or sent the notice but failed to force-place insurance after 45 days.
- The loan staff did not understand the regulatory requirement for force-placement insurance.

Compliance Risk Management

Some steps lenders can undertake to help reduce the risk of force-placement violations include:

- *FEMA changes to flood insurance maps.* Many force-placement violations occurred when flood maps changed, but a lender was not aware of the changes affecting properties securing its loans. Hiring a reputable life-of-loan vendor and carefully monitoring communications from the vendor for remapped properties can reduce this risk.
- *Monitoring, audit, and corrections.* Introducing monitoring and audit programs can help to ensure a bank becomes aware when a property has no insurance or inadequate insurance. In addition, lenders may want to ensure they address any flood insurance issues identified during audit

or compliance reviews in a timely manner and implement responsive procedures to ensure compliance going forward.

- *Tickler systems.* A lender can use a tickler system that provides notifications of flood insurance policies nearing renewal dates and generates notices to borrowers to provide proof that the policy was renewed in the proper amount. An additional sound practice is to assign more than one person to monitor the tickler system for backup.
- *Training.* A lender can provide training to the lending staff. Examiners see greater levels of compliance when all parties responsible for complying with procedures relative to flood insurance receive appropriate and regular training on their duties under the flood insurance provisions of Regulation H.

Regulation Z — Truth in Lending Act

Congress enacted the Truth in Lending Act (TILA) “to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.”¹⁰ One of TILA's primary goals is uniform credit cost disclosures. TILA is implemented by Regulation Z.

Understated Finance Charges — 12 C.F.R. §1026.18(d)

Regulatory requirements

To help achieve uniform credit costs disclosures, Regulation Z requires creditors to calculate and disclose the “finance charge,” as defined in 12 C.F.R. §1026.4(a):

The finance charge is the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. It does not include any charge of a type payable in a comparable cash transaction.

For residential mortgage loans, calculating the finance charge can be challenging because a lender must determine which of its fees and charges are incidental to the extension of credit and would not be charged to cash customers and therefore qualify as finance charges.

The regulation also requires disclosure of prepaid finance charges, which are defined as “any finance charge paid separately in cash or by check before or at consummation of a transaction, or withheld from the proceeds of the credit at any time.”¹¹ These typically occur in residential mortgages. For example, discount points paid at closing to lower the mortgage loan rate qualify as a prepaid finance charge.

Common Violations

A common Regulation Z violation is understating finance charges for closed-end residential mortgage loans by more than the \$100 tolerance permitted under Section 18(d). Examination data indicated that this violation typically occurred because either the lender had insufficient knowledge of what constitutes a finance charge across varying circumstances or because of incorrect configuration or use of disclosure software. For example, one Report of Examination found that a bank did not subtract the origination fee from the amount financed, resulting in an understated finance charge disclosed to the customer. Examiners also found instances in which some prepaid charges — such as monthly guaranty payments, inspection fees, settlement and closing fees, and title fees — were not included in the finance charge, leading it to be understated by more than the \$100 tolerance.

Another common violation was related to software platform deficiencies. In some instances, these platforms included default settings that erroneously allowed the loan processor to bypass the proper finance charge designation during the setup of required disclosures.

**REGULAR SUBSTANTIVE TRAINING
ON FINANCE CHARGE DEFINITIONS
AND DISCLOSURE REQUIREMENTS
FOR LOAN PROCESSORS AND
LENDERS WOULD BE BENEFICIAL.**

Compliance Risk Management

Lenders can take several steps to help mitigate the risk of a potential Regulation Z violation:

- *Training.* Many finance charge errors occurred because the staff did not understand the regulation's technical provisions. Regular substantive training on finance charge definitions and disclosure requirements for loan processors and lenders would be beneficial. *Outlook* published an article in 2017 titled "Understanding Finance Charges for Closed-End Credit," which reviewed the technical requirements in detail. Training that promotes an understanding of whether any particular charge meets the finance charge definition based on its purpose, rather than the name of the charge, can be especially helpful.

- *Policies and procedures.* Documents that provide visual representation of all of the lender's applicable loan fees and the instances in which they are deemed prepaid finance charges can be particularly helpful. These types of documents give loan processors and lenders ready assistance with the nuances of each potential charge in each potential circumstance.
- *Oversight of software.* When lenders install new automated loan software, employees often need time to become accustomed to the software. To help prevent finance charge violations resulting from the transition to new software, lenders should account for the time needed to integrate new systems, and strengthen the monitoring, oversight, and auditing of these systems.

FAIR CREDIT REPORTING ACT

The Fair Credit Reporting Act (FCRA) regulates consumer credit reports, furnishers of credit information, and the consumer reporting agencies: 15 U.S.C. §1681a et seq.; 12 C.F.R. Part 1022. To help alert consumers to negative information in their credit report and its impact, the FCRA requires notices to consumers in certain circumstances.

Adverse Action Disclosure — 15 U.S.C. §1681m(a); FCRA Section 615(a)

Statutory Requirements

Section 615(a) of the FCRA requires that when a user of a consumer report takes adverse action against a consumer based in whole or part upon information in the report, the user must provide an adverse action notice to the consumer. If a credit score was relied on in taking the adverse action, the score must also be disclosed along with the consumer reporting agency from which the report was obtained as well as instructions on obtaining reports from the agency. Institutions often combine the FCRA adverse action disclosures with those required under Regulation B and the Equal Credit Opportunity Act when taking adverse action against a consumer.

Common Violations

Violations of FCRA's adverse action notice requirements were more common in recent examinations than in examinations reviewed in the 2012 *Outlook* article. Many violations concerned failing to provide required disclosures such as credit score disclosures, range of credit scores, or information about the consumer reporting agency providing the consumer report. Section 1100F of the Dodd–Frank Wall Street Reform and Consumer Protection Act added credit score disclosure requirements for FCRA adverse action notices and risk-based pricing notices. This change did not become effective until August 15, 2011, and provides context for the increase in FCRA violations.¹²

Compliance Risk Management

Institutions can take several steps to help mitigate the risk of a potential FCRA violation:

- *Oversight of software.* Several examinations attributed the failure to include all required disclosures in adverse action notices to the bank's disclosure software. The software relied on parameters to trigger disclosures, and the software parameters were incorrectly set so that mandatory information was not automatically generated and printed. Reviewing and validating the parameters can address this problem.
- *Training, policies, and procedures.* Similar to the violations discussed earlier, another root cause of the FCRA violation is that employees did not fully understand regulatory requirements. To ensure future compliance, the strategies for CMS enhancements described throughout this article apply here, too; namely, the use of training, policies, and procedures to ensure the bank provides the required FCRA disclosures.
- *Checklists.* The use of checklists to record (1) whether FCRA disclosures are required for the particular transaction, and (2) whether, when, by whom, and by what means such disclosures were provided to the applicant. This is more effective when checklists are part of a preclosing review.
- *Audits and monitoring.* As discussed for other common violations, internal audits or monitoring can also help prevent or identify violations.

THROUGH AWARENESS AND TRAINING, A COMPLIANCE OFFICER CAN HELP ENSURE THAT THE FINANCIAL INSTITUTION AND ITS STAFF COMPLY WITH CONSUMER PROTECTION LAWS AND REGULATIONS.

CONCLUSION

This updated article on common violations identified by Federal Reserve System bank examiners revealed that some common violations identified in 2011 still persist, while new common violations also were found. Through awareness and training, a compliance officer can help ensure that the financial institution and its staff comply with consumer protection laws and regulations. These sound practices can help accomplish this, provided they are tailored to each institution's specific challenges. Specific issues and questions should be raised with your primary regulator. ■

ENDNOTES

- 1 Equal Credit Opportunity Act, Pub. L. No. 93-435, §502, 88 Stat. 1500, 1521 (October 24, 1974)(codified at 15 U.S.C. §1691 Note) (emphasis added).
- 2 Comment 7(d)(1)-3.
- 3 12 C.F.R. §1002.2(j) defines credit as "the right granted by a creditor to an applicant to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment therefor."
- 4 Comments 7(d)(2)-2 (unsecured credit) and 7(d)(4)-2 (secured credit).
- 5 Comment 7(d)(1)-3.
- 6 See S. Rep. 93-583, p. 4.
- 7 Danielle Martinage, "Vendor Management Considerations for Flood Insurance Requirements," *Consumer Compliance Outlook* (Issue 2 2019).
- 8 Doing so may result in a change of procedures, as well as for those institutions currently not using similar checklists.
- 9 See the Federal Reserve's *Consumer Compliance Handbook* (December 2016), p. 9.
- 10 See 15 U.S.C. §1601(a).
- 11 See 12 C.F.R. §1026.2(a)(23).
- 12 See 76 *Federal Register* 41602 (July 15, 2011).



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BOARD PUBLISHES SECOND ISSUE OF CONSUMER COMPLIANCE SUPERVISION BULLETIN

The Board of Governors of the Federal Reserve System recently published the second issue of its *Consumer Compliance Supervision Bulletin*. The publication provides high-level summaries of issues for senior executives in banking organizations and complements other aspects of the Federal Reserve's outreach programs for its supervised institutions.

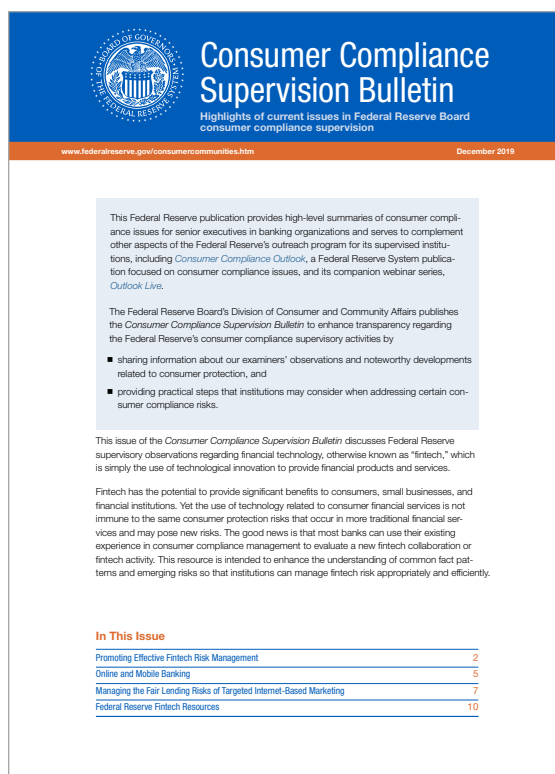
The Board's Division of Consumer and Community Affairs publishes the *Bulletin* to enhance transparency about the Federal Reserve's consumer compliance supervisory activities by:

- sharing information about the Federal Reserve System's examiners' observations and other noteworthy developments related to consumer protection, and
- providing practical steps that institutions may consider when addressing certain consumer compliance risks.

This issue discusses Federal Reserve supervisory observations on three topics:

- Fintech
- Online and Mobile Banking
- Fair Lending Risks of Targeted Internet-Based Marketing

The *Bulletin* is available on the Board's website at <https://www.federalreserve.gov/publications/2019-december-consumer-compliance-supervision-bulletin.htm>. ■



COVID-19 RESOURCES

The Federal Reserve Board has created a resource page of COVID-19 resources and supervisory actions, which is available at

<https://www.federalreserve.gov/covid-19.htm>

REGULATORY CALENDAR

EFFECTIVE DATE†	IMPLEMENTING REGULATION	REGULATORY CHANGE
1/24/20	12 U.S.C. §5531(a)	The Consumer Financial Protection Bureau's statement of policy regarding prohibition on abusive acts or practices
1/1/20	Reg. C	Final rule extending temporary HMDA exemption threshold of 500 open lines of credit until 1/1/22
1/1/20	Reg. Z	Final rule implementing inflation adjustment to the threshold for smaller loan exemption from appraisal requirements for higher-priced mortgage loans
1/1/20	Regs. Z and M	Final rule implementing dollar thresholds under Regulations Z and M for exempt consumer credit and lease transactions
11/19/20	12 C.F.R. Part 1041	Final rule delaying compliance date for mandatory underwriting provisions of the payday lending rule
7/1/2020 (most provisions)	Reg. CC	Final rule implementing required adjustments to the Expedited Funds Availability Act's (EFAA) dollar amounts
11/24/19	Reg. Z	The Bureau's interpretive rule under Regulation Z under the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act)
*	Reg. E	Proposed rule increasing exemption threshold to 500 transfers and to make temporary use of estimates by depository institutions permanent
*	Reg. C	Proposed rule amending the HMDA reporting thresholds for closed-end and open-end loans
*	Reg. C	Advanced notice of proposed rulemaking to eliminate some of the HMDA data fields
*	Reg. F	Proposed rule implementing the Fair Debt Collection Practices Act

† Proposed rules do not have an effective date.

SENIOR SAFE ACT

On May 24, 2018, the Senior Safe Act (the act) was signed into law as Section 303 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. Subject to certain conditions, the act provides immunity from liability, including in any civil or administrative proceeding, to a covered financial institution and certain of their employees or other individuals affiliated or associated with the institution for reporting suspected exploitation of a senior citizen to covered agencies.

In addition to other requirements, the specified employees or other individuals affiliated or associated with a covered institution must receive the training required by the act to qualify for immunity. Reporting suspected senior financial exploitation under the act is optional, but institutions must comply with requirements of the act for immunity to apply.

Additional requirements under the act are discussed in the following Q&A:

Q Which individuals are eligible for immunity, and how can an individual obtain such immunity under the act?

- A** An individual can obtain immunity from disclosure of suspected exploitation of a senior citizen to a covered agency if:
- the individual received the training specified in the act (described next),
 - at the time of disclosure, the individual served as a supervisor or in a compliance or legal function (including as a Bank Secrecy Act officer) for, or in the case of a registered representative, investment adviser representative, or insurance producer, was affiliated or associated with, a covered financial institution, and
 - at the time of disclosure, the individual made the disclosure in good faith and with reasonable care.

Q Which institutions are eligible for immunity, and how can a covered financial institution obtain such immunity under the act?

- A** A covered financial institution is:
- a depository institution
 - a credit union
 - an investment adviser
 - a broker-dealer
 - an insurance company
 - an insurance agency, or
 - a transfer agent.

Under the act, a covered financial institution can obtain immunity from disclosure of suspected exploitation of a senior citizen to a covered agency made by an individual described previously if:

- at the time of disclosure, the individual was employed by, or, in the case of a registered representative, investment adviser representative, or insurance producer, was affiliated or associated with, the covered financial institution, and
- before disclosure, the individual was provided the training specified in the act (described next).

Q What is a covered agency?

A Covered agencies include state and federal regulatory agencies, law enforcement agencies, and local agencies responsible for providing adult protective services. The act defines covered agency as:

- the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the National Credit Union Administration, and the Consumer Financial Protection Bureau
- a law enforcement agency
- a state or local agency responsible for administering adult protective service laws
- a state financial regulatory agency
- certain securities associations, and
- the Securities and Exchange Commission.

Q What are the training requirements under the act?

A To qualify for immunity from suit, the individuals specified previously must receive training, among other requirements, if the individual:

- may come into contact with a senior citizen as a regular part of his or her professional duties, or
- may review or approve the financial documents, records, or transactions of a senior citizen in connection with providing financial services to a senior citizen.

The training may be provided by a covered financial institution or a third party selected by the covered institution. The training generally must:

- review common signs of financial exploitation of a senior citizen
- explain how to identify and report suspected senior citizen exploitation
- discuss the need to protect each customer's privacy and respect each customer's integrity, and
- be appropriately tailored to an individual's job responsibilities.

Q When must the training be provided?

A Generally, training must be provided as soon as possible. For individuals who become employed, or affiliated or associated with, a covered financial institution after the effective date of the act, training must be provided within one year from the date of employment, affiliation, or association.

Q What are the recordkeeping requirements for the training?

A Covered financial institutions are required to maintain a record of the individuals described previously who are employed by, or affiliated or associated with, the covered institution and have completed the training. Upon request, the covered financial institution must provide such records to a covered agency with examination authority over the institution. In addition, the content of the training must be maintained by the covered financial institution and, upon request, be made available to a covered agency with examination authority over the institution. The covered institution, however, is not required to maintain or make available such content with respect to an individual who is no longer employed by, or affiliated or associated with, the institution.

Q When did the law become effective?

A The act became effective on May 24, 2018. ■

NEWS FROM WASHINGTON: REGULATORY UPDATES*

The Consumer Financial Protection Bureau (Bureau) Announces Its Enforcement and Supervision Policy for Abusive Acts or Practices. On January 24, 2020, the Bureau published a policy statement to clarify its supervisory and enforcement policy for abusive acts or practices. The Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank Act) authorized the Bureau to take action against unfair, deceptive, or abusive acts or practices against consumers by covered entities in connection with a consumer financial product or service. The Bureau issued the statement because it had concluded the industry was uncertain how the Bureau would apply the abusive standard.

The statement clarified that the Bureau generally will apply three principles in supervising and enforcing the abusive standard:

- The Bureau intends to cite conduct in supervision or challenge conduct in enforcement as abusive if, among other standards, the harm to consumers outweighs its benefits to consumers;
- The Bureau will avoid challenging conduct as abusive if the same facts are challenged as unfair or deceptive. If conduct is challenged as abusive, the Bureau intends to plead the abusive claims in a manner that demonstrates the connection between the facts of the case and the legal standard for abusiveness. The Bureau intends to apply the same approach to citing conduct as abusive in supervision. Similarly, in future editions of the Bureau’s Supervisory Highlights publication, the Bureau intends to provide more clarity as to the specific factual basis for determining abusiveness in the supervision process; and
- The Bureau does not intend to seek certain types of monetary relief for abusiveness violations if the covered person made a good faith effort to comply with the abusiveness standard.

The statement was effective on January 24, 2020, and is available on the Bureau’s website.

The Bureau proposed to amend the remittance transfer rule to expand the exemption threshold from 100 to 500 transfers and to create two new permanent exceptions for certain providers to use estimates.

On December 6, 2019, the Bureau issued a notice of proposed rulemaking for Regulation E to amend the remittance transfer rule, 12 C.F.R. Part 1005, subpart B.

First, the Bureau proposes to increase the threshold for remittance transfer providers exempt from the rule’s requirements from 100 transfers in the prior calendar year to 500 transfers. Second, the Bureau proposes a new permanent exception for insured institutions to estimate the exchange rate for transfers to a particular country if the insured institution made 1,000 or fewer remittance transfers in the previous year to that country in the country’s local currency and the institution is not able to determine the exact exchange rate. Third, the Bureau proposes a new permanent exception for insured institutions to estimate covered third-party fees associated with a transfer to a designated recipient institution if the insured institution has made 500 or fewer remittance transfers in the previous year to that recipient institution and the sending institution is not able to determine the amount of the third-party fees. The Bureau intends these changes to mitigate the effects of the expiration on July 21, 2020, of a temporary exception that allowed insured institutions to use estimates for certain disclosures.

The Bureau seeks comment on its proposal to assess the effectiveness of the TILA-RESPA integrated disclosure (TRID) rule. Under Section 1022(d) of the Dodd–Frank Act, the Bureau is required to assess the effectiveness of its significant rules five years after their effective date. On November 22, 2019, the Bureau published a notice in the *Federal Register* seeking public comment pursuant to Section 1022(d) of the effectiveness of the TRID final rule. The request sought comment on the rule, including these topics:

- the benefits and costs of the TRID rule for consumers, creditors, or other stakeholders;
- information about the effects of the rule on transparency, efficiency, access, and innovation in the mortgage market;
- information about the rule’s effectiveness in meeting the objectives of the Dodd–Frank Act;
- comments on aspects of the TRID rule that are confusing or where more guidance was needed to implement the rule;
- recommendations for modifying, expanding, or eliminating the TRID rule.

The comment period closed on January 21, 2020.

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

The Bureau issues a report on mortgage servicers. On November 21, 2019, the Bureau's Office of Research issued a report detailing its findings about mortgage servicers. The report categorized servicers into three categories:

- Small servicers: 5,000 or fewer loans. Small servicers are exempt from certain provisions of the RESPA and TILA servicing rules;
- Midsize servicers: between 5,000 and 30,000 loans;
- Large servicers: more than 30,000 loans.

The report included the following findings:

- 74 percent of borrowers with mortgages at small servicers said an important factor in choosing their lender was either that they had an established banking relationship or that the lender had a local office or branch nearby. By contrast, only 44 percent of borrowers with mortgages at large servicers cited the importance of having a local office or branch nearby.
- 23 percent of small servicers' mortgages are secured by homes in nonmetro or rural counties, while nationwide, 11 percent of mortgages are in nonmetro or completely rural counties. In a number of rural counties in the United States, small servicers service the majority of loans, especially in certain Midwestern states.
- Small servicer loans are less likely to have been originated by a government-backed loan or by government-sponsored enterprises, compared with mortgages serviced by larger servicers.

The report is available at the Bureau's website.

The Bureau issues an interpretive rule clarifying Regulation Z loan originator screening and training requirements for individuals with temporary authority under the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) to originate residential mortgage loans. On November 19, 2019, the Bureau issued an interpretive rule to clarify that a mortgage loan originator organization is not required to apply Regulation Z's screening and training qualification requirements to loan originators with temporary authority under the SAFE Act to originate mortgages in the state. This applies to loan originators who are previously state licensed or federally registered, employed by a state-licensed mortgage company, have applied for a new state loan originator license, and have met other criteria in the SAFE Act. These originators may act as a mortgage loan originator, while the relevant state authority completes its processes for granting or denying a state loan originator license.

The SAFE Act requires that states screen and train state-licensed mortgage loan originators; it does not prescribe such requirements to federally registered originators. However, TILA and Regulation Z also include loan originator qualification requirements. Specifically, if an originator is not required to be state licensed and is not state licensed, a loan originator organization must complete certain screening and provide certain training before permitting the individual to act as a loan originator in a consumer credit transaction secured by a dwelling. After reviewing the applicable legal requirements, the Bureau determined Regulation Z screening and training requirements do not apply to individual loan originator employees with SAFE Act temporary authority. The interpretive rule was effective on November 24, 2019.

Agencies Announce Threshold for Smaller Loan Exemption from Appraisal Requirements for Higher-Priced Mortgage Loans. On October 30, 2019, the Board, the Bureau, and the Office of the Comptroller of the Currency announced that the threshold exempting loans from special appraisal requirements for higher-priced mortgage loans increased from \$26,700 in 2019, to \$27,200 in 2020, 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.

The Federal Reserve Board and the Bureau Announce Dollar Thresholds in Regulations Z and M for Exempt Consumer Credit and Lease Transactions. On October 30, 2019, the Board and the Bureau announced the dollar thresholds that will apply under Regulation Z (Truth in Lending Act (TILA)) and Regulation M (Consumer Leasing Act or CLA) to determine exempt consumer credit and lease transactions in 2020. The annual adjustment is based on the annual percentage increase in the CPI-W. If the CPI-W average has not increased, the Board and the Bureau maintain the exemption threshold from the prior year. Transactions at or below the thresholds are subject to the protections of the regulations.

Based on the annual percentage increase in the CPI-W as of June 1, 2019, the protections of the TILA and the CLA will generally apply to consumer credit and lease transactions of \$58,300 or less in 2020. Note, however, that private education loans and loans secured by real property (such as mortgages) are subject to the TILA regardless of the loan amount.

ON THE DOCKET: RECENT FEDERAL COURT OPINIONS*

TRUTH IN LENDING ACT (TILA) — REGULATION Z

The Third Circuit holds that an extension of consumer credit was not subject to the TILA because the plaintiff had not signed a written agreement. *Wolfington v. Reconstructive Orthopaedic Assocs.* II PC, 935 F.3d 187 (3rd Cir. 2019). The plaintiff agreed to undergo surgery by the Rothman Institute, for which his insurance had a \$2,000 deductible. Prior to the surgery, the plaintiff's father notified Rothman that he could not afford to pay the deductible. The parties orally agreed that the plaintiff could pay \$200 initially and the balance in monthly installments. Rothman later sent the plaintiff two emails confirming this agreement. After the surgery, the plaintiff failed to make the monthly payments and filed a class-action lawsuit against Rothman alleging it extended consumer credit without providing TILA disclosures. The district court dismissed the lawsuit, holding that Rothman was not a creditor subject to Regulation Z's requirements because a written agreement had not been executed.

On appeal, the Third Circuit affirmed the District Court's judgment on the TILA claim. The court noted that the regulation defines a creditor as a "person who regularly extends consumer credit that is subject to a finance charge or is *payable by written agreement* in more than four installments. ..." 12 C.F.R. §1026.2(a)(17) (emphasis added). The court found that, while the oral agreement to defer payment of the deductible in monthly installments constituted an extension of credit, the plaintiff failed to establish that it was done under a written agreement. In particular, the court cited a Federal Reserve Official Staff Interpretation, which interpreted the definition of creditor to require a written agreement "executed by the customer." The unilateral email communications from Rothman to the plaintiff confirming the oral agreement were deemed insufficient because the plaintiff had not signed them. The plaintiff tried to dispute whether the court was required to defer to an agency interpretation of a statute it is charged with implementing. But the court found the staff interpretation was entitled to deference because it satisfied the requirements for a court to defer to an agency interpretation of its own regulations under Supreme Court precedent.

The Ninth Circuit holds that a mortgage loan to reacquire a previously owned residential property is a "residential mortgage transaction" not subject to the right of rescission. *Barnes v. Chase Home Finance, LLC.*, 934 F.3d 901 (9th Cir. 2019). Under TILA, creditors must provide borrowers a notice of the right of rescission for credit transactions creating a security interest in the borrower's principal dwelling. The TILA creates an exception, however, for a "residential mortgage transaction," which is defined as a loan "to finance the acquisition or initial construction of [a consumer's] dwelling" that is secured by that dwelling: 15 U.S.C. §1602(x); 12 C.F.R. §1026.2(a)(24). This appeal of the lower court's decision, which granted summary judgment in favor of the defendant, involved the narrow issue of whether a mortgage loan to reacquire a property the borrower previously owned constitutes a residential mortgage transaction that is not subject to rescission.

In 1990, the plaintiff and his wife financed the purchase of their residence. The wife subsequently transferred her interest in the property to the plaintiff, and he later transferred the entire interest back to her. The couple later divorced, and the residence was awarded to the plaintiff. However, the divorce judgment required him to refinance the indebtedness on the property his wife incurred when she owned it and to pay her \$100,000. The plaintiff obtained a mortgage loan from Chase for \$378,250 to satisfy his wife's loan and pay her the \$100,000 as required by the divorce judgment. He later sued Chase to rescind the loan because he was not provided with a notice of the right of rescission under the TILA. The district court held that a loan to reacquire a dwelling met the definition of a residential mortgage transaction and, therefore, is not entitled to the right of rescission under the TILA and dismissed the lawsuit.

On appeal, the Ninth Circuit agreed that the statutory language in the TILA is unambiguous and that the definition of a "residential mortgage transaction" includes both a loan to finance and acquire a dwelling and a loan to finance and reacquire a dwelling where the prior interest was fully extinguished. The Ninth Circuit Court of Appeals therefore affirmed the district court's summary judgment in favor of the defendant.

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



ELECTRONIC FUND TRANSFER ACT (EFTA) – REGULATION E

The Eleventh Circuit rules a financial institution potentially violated Regulation E by failing to disclose in its overdraft opt-in notice that it uses the available balance method to calculate overdraft fees. *Tims v. LGE Community Credit Union*, 935 F.3d 1228 (11th Cir. 2019). The plaintiff opened an account with LGE Community Credit Union (LGE) and was provided with a verbatim copy of Regulation E’s model consent form (A-9) for overdraft fees. After LGE later assessed the plaintiff fees for overdrawing her account, she filed a class-action lawsuit alleging, in part, the opt-in notice did not describe LGE’s overdraft service in a “clear and readily understandable way,” as the regulation requires, because the use of the available balance method was not disclosed. This method takes into account pending transactions when determining if an account is overdrawn. The LGE notice, which used the exact language of the model form, said an overdraft occurs when there is not “enough money in your account.” The plaintiff said this language described the ledger balance method of calculating the balance, which would not have overdrawn her account had it been used. The district court granted LGE’s motion to dismiss after determining the agreements unambiguously permitted LGE to assess overdraft fees using the available balance calculation method.

On appeal, the Eleventh Circuit reversed, finding that it was ambiguous whether the model form described the available balance or ledger balance method. The court therefore found the plaintiff had a plausible claim that LGE did not describe the overdraft service in a “clear and readily understandable way.” The court also found a potential violation for not providing the plaintiff a reasonable opportunity to affirmatively consent to the overdraft services, as the regulation requires “because the notice gave her no way to know whether LGE would use the available balance or the ledger balance method to charge her overdraft fees.”

Finally, the court rejected LGE’s argument that its use of the model form protected it from liability. “The safe-harbor provision insulates financial institutions from EFTA claims based on the means by which the institution has communicated its overdraft policy. But it does not shield them for claims based on their failure to make adequate disclosures. A financial institution thus strays beyond the safe harbor when communications within its overdraft disclosure inadequately inform the consumer of the overdraft policy that the institution actually follows.” The case was remanded to the district court.

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA) — REGULATION X

The Sixth Circuit rejects a lawsuit against a servicer in which the plaintiff was listed only on the mortgage, and not the note, because only persons personally obligated under a loan agreement have a standing under RESPA to sue. *Keen v. Helson*, 930 F.3d 799 (6th Cir. 2019). The plaintiff and her now-deceased husband financed the purchase of a home with a loan on which only he was liable, while they were both listed on the mortgage securing the loan. When the couple divorced, the plaintiff received full title to the house. After she defaulted on the mortgage payments, the servicer foreclosed and sold the property. The plaintiff’s lawsuit alleged the servicer violated the RESPA by failing to provide her with options to avoid foreclosure when she requested them. The district court dismissed the case after concluding that only “borrowers” can sue under RESPA, and she did not sign the loan instrument.

On appeal, the Sixth Circuit affirmed, holding that RESPA only provides a cause of action to “someone who is personally obligated on a loan—i.e., someone who is actually borrowing money.” The plaintiff was not a borrower under this definition so the court affirmed the dismissal of the lawsuit. To support her position, the plaintiff pointed to, among other sources, the Bureau’s RESPA regulations, which define a “borrower” to include a “successor in interest”; namely, a “person to whom an ownership interest in a property securing a mortgage loan ... is transferred from a borrower.” 12 C.F.R. §§1024.30 and .31. The court gave no weight to the Bureau regulations in this regard, however, in part because the “successor in interest” provisions went into effect after the events giving rise to the case.

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CALENDAR OF EVENTS

Outlook regularly publishes upcoming compliance events that may be of interest to our readers. Because most events have been canceled in response to the COVID-19 pandemic, we are not listing events for this issue. We will resume publishing events when the crisis has subsided and events are rescheduled.

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