

# CONSUMER COMPLIANCE OUTLOOK®

A FEDERAL RESERVE SYSTEM PUBLICATION FOCUSING ON CONSUMER COMPLIANCE TOPICS

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## THE BENEFITS OF A PROACTIVE COMPLIANCE PROGRAM

BY KATHLEEN BENSON, LEAD EXAMINER, FEDERAL RESERVE BANK OF CHICAGO

“You can pay me now, or pay me later.”

FRAM, one of America's leading automotive oil filter brands, debuted its well-known slogan back in 1971.<sup>1</sup> Almost 50 years later, this slogan continues to resonate. The small investment in regularly changing a car's oil filter can help prevent costly repairs from engine failure. Similarly, a proactive consumer compliance management system (CMS) can be an effective tool for financial institutions to help prevent program breakdowns.

Proactive compliance systems that anticipate likely issues may cost more or require more structure in the immediate term — the “pay me now” part of the slogan. But over the long term, they are usually less costly than programs that only respond to problems once auditors, customers, or regulators identify them. Depending on the severity of a compliance issue, a bank's reactive program may be no better off than the seized up engine envisioned in the “pay me later” part of FRAM's well-known advertisement.

Large-scale compliance problems can lead to redisclosure, reimbursement, or other required corrective action, which expose the institution to increased costs or may harm its reputation with its customers. In addition to avoiding these negative outcomes, a proactive CMS provides clarity to management and employees about legal and regulatory compliance requirements, as well as a risk management structure that empowers them to identify and resolve issues before they escalate, contributing to a culture of compliance. The Federal Financial Institutions Examination Council (FFIEC) Uniform Interagency Consumer Compliance Rating System (CC Rating System), released by the FFIEC on November 7, 2016, also encourages institutions to prevent, self-identify, and address compliance issues.<sup>2</sup> This article will cover the benefits of implementing a proactive CMS, define its elements, and share examples based on examiner observations.

### WHAT IS PROACTIVE COMPLIANCE?

Merriam-Webster defines *proactive* as “acting in anticipation of future problems, needs, or changes.”<sup>3</sup> From a CMS perspective, a proactive approach requires an institution's board of directors (board) and management to be knowledgeable of and identify compliance risk in the organization and to implement risk mitigation strategies appropriate for their defined risk appetite.

Some of the practices we have observed in institutions with proactive compliance programs include documenting critical policies and procedures in writing, implementing robust training methods, and establishing monitoring and audit parameters based on product or compliance risk. In addition to a compliance policy and lending standards established within a bank's loan policy, written lending-related procedures frequently include areas such as loan

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# EFFECTIVE BANK COMMUNICATIONS ENHANCE COMPLIANCE AND CUSTOMER SATISFACTION

BY JOEL ARMSTRONG, SENIOR COUNSEL, FEDERAL RESERVE BOARD, AND ALINDA MURPHY, SENIOR EXAMINER, FEDERAL RESERVE BANK OF KANSAS CITY

Every day, the nation's banks — ranging from the smallest community banks to the largest financial institutions — communicate with their customers. These communications are a critical aspect of a bank's operations because the messages share priorities, provide updates on important issues, and convey an institution's culture to its customers and communities. Moreover, during periods of economic or social stress and bank operational change, effective communication is necessary to share clear and consistent messages that support the bank–customer relationship. Reviewing those communications can enhance the customer experience and mitigate regulatory, legal, and reputational risks, thus contributing to business success. Banks can control their communications and manage their messaging by implementing policies and practices around a clearly defined corporate culture.<sup>1</sup> Effective compliance programs monitor how bank communications enact corporate principles and identify areas where stronger controls may be required. This article provides ideas on how to assess consumer compliance risks in customer communications and strategies for enhancing a bank's risk controls.

## UNDERSTANDING DIFFERENT METHODS USED TO COMMUNICATE WITH CUSTOMERS

Identifying the various communication channels a bank uses to convey messages to its customers and communities can be a useful first step in promoting effective communication. One approach is to first categorize communications, including oral communications, hard-copy documents, and digital media and electronic communications, which include online platforms such as email, social media, the web, and mobile banking.

Second, the bank may consider whether it uses multiple communication methods for a single customer transaction. For example, loan operations may have separate communications for applications, underwriting, originations, servicing, and collections. Similarly, deposit account operations may have separate communications for onboarding, transaction information, error resolution, and collection functions.

Third, the bank may review whether it communicates with customers, the community, or other business partners through automated systems or third-party vendors. For example, automated and third-party communications could include using interactive voice response systems that intersperse information about bank products between musical selections or the information the bank furnishes to consumer reporting agencies.<sup>2</sup>

Regardless of bank size or complexity, the resulting list of communication methods the bank uses may be extensive. After the communication methods are identified, it may be appropriate to concentrate compliance resources on the types of communications most likely to result in consumer harm or pose the highest risk of not complying with federal consumer protection laws and regulations. Some banks attribute lower risk to written communications, such as disclosures and notices (e.g., ATM receipts) that have undergone robust compliance reviews. Communications focusing solely on bank name recognition and containing no statements about bank products or services may have lower compliance risk. Consumer chats, text-messaging services, and oral communications during in-person and telephone contacts often pose higher compliance risk absent strong procedures, controls, and

monitoring. In addition, communications designed to reach specific populations, such as seniors, racial or ethnic groups, or residents in certain geographic locations, may present higher compliance, legal, and reputational risks.<sup>3</sup>

### **PROVIDING CUSTOMERS WITH CONSISTENT, ACCURATE, AND APPROPRIATELY PRIVATE INFORMATION**

Bank communications should accurately reflect the bank's products and services and maintain the appropriate level of privacy. Failures in these areas expose the bank to compliance, legal, and reputational risks for violating federal consumer protection laws and regulations, including Section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive acts or practices (UDAP).<sup>4</sup> Several of these laws and regulations require accurate written and oral bank communications.<sup>5</sup> A bank may consider the following methods to assess the effectiveness of its communications and whether they comply with federal consumer protection laws and regulations.

#### **Compare Communications**

After identifying bank communications and assessing the risks they pose, a bank may review high-risk communications as an additional control — for example, to ensure they accurately reflect the bank's policies and practices. A good starting place may be to evaluate whether the information in those communications is consistent with other written documents, scripts, automated messages, marketing, all types of Internet activity, and recordings. Reviews for consistent communications may also consider the timeframes within which communications are provided to ensure that promotions or other time-sensitive communications were appropriately and consistently handled. It may also be useful to review a sample of internal and third-party service provider (TSP) recordings, emails, and social media communications for consistency.

#### **Protect Customer Privacy**

Banks should communicate information with an appropriate level of security and privacy, consistent with applicable laws and regulations. Privacy requirements cover written and oral communications that may range from email transmissions to conversations in a branch lobby.<sup>6</sup> Consistent with applicable law, written, electronic, and oral privacy disclosures to customers should accurately reflect the bank's policy and practices related to the release of nonpublic, personal financial information and data sharing.<sup>7</sup> For example, a teller who orally states the balance remaining in a customer's account or the amount of funds being withdrawn in a manner that may be clearly overheard by others in the lobby. This could expose the customer's nonpublic personal information to other customers or potential fraudsters and violate privacy and other consumer protection laws and regulations.

#### **Train Frontline Staff**

Training the bank's frontline staff members to ensure they have access to and understand the appropriate bank systems

and procedures for providing information to customers may be useful. For example, bank staff can be trained to avoid providing inconsistent deposit interest rate information to customers because of different internal databases. As another example, administrative staff, loan officers, and underwriters can be trained to provide consistent messages to a customer regarding the status of a loan application regardless of the message source. In addition, staff can be trained to provide consistent information to customers for loan and deposit account transactions, including fees, interest rates, and loan or deposit balances — regardless of how customers receive that information from the bank. To avoid compliance pitfalls, staff can be trained in providing accurate and consistent messaging to prevent discrepancies between hard-copy and electronic contracts, disclosures, notices, marketing materials, scripts, chat logs, and staff and TSP oral statements.

#### **Prepare a Contingency Plan**

Strong compliance programs generally have risk management strategies that include contingency planning to help the bank adapt to changing internal and external situations. Effective bank communication plans consider the possibility that events may occur that require implementing new or flexible ways of communicating with customers and communities.<sup>8</sup>

Providing accurate and consistent messaging can be particularly important when a bank experiences a problem with its operations. For example, a bank customer contacted a Federal Reserve Bank to express concern that a branch closed for the afternoon without advance notice or signage. Customers contacting other bank locations were provided different explanations for the branch closure, leading to rumors within the small community that ranged from a computer system failure to the bank's permanent closure. In fact, the branch closed because of an isolated area power outage. The situation presented substantial reputational risk because bank management had no contingency plan to ensure its staff was armed with timely, accurate information and for timely customer messaging such as posted notices.

As another example, a bank closed multiple branch locations in response to the current pandemic health crisis but delayed posting signs with accurate information about which branches remained open. This delay resulted in increased call volume and customer complaints about long hold times. The bank also received complaints from customers traveling to multiple branches to find an open lobby. In addition to posting accurate signs at closed branches, the bank ultimately updated the branch information on its website and emailed accurate branch closure information to its customers.

Effective communication can also help during an operation's emergency if the bank must reduce customers' access to some channels and redirect them to other channels. A natural disaster might make customers more reliant on drive through, telephone, and mobile applications to obtain services. Such unplanned limitations on customer access highlights the importance of contingency planning covering all communication exigencies.

## Designate Spokespersons

Typically, a strong communication compliance strategy clearly identifies who communicates bank messages to customers and the public as well as the types and timing of the messages communicated. Banks can establish a governance structure defining roles and responsibilities, including who will speak, talk, post, tweet, chat, or email on behalf of the bank. For example, a bank can develop a process for how and when a

loan officer may appropriately communicate an underwriting decision or policy to a credit applicant. Compliance issues have arisen when loan officers erroneously indicated favorable credit decisions before bank underwriting staff had made a final determination regarding a loan application. The complexity of the product or service and the nature of customer contacts may make it feasible to provide designated bank staff with scripts to ensure appropriate messaging. If the

## Communication Risks Can Result in UDAP Concerns

Communications that are inaccurate, misleading, do not align with actual benefits customers will receive, or omit information customers need to make informed decisions pose substantive legal, reputational, and compliance risks pursuant to Section 5 under the Federal Trade Commission Act, which prohibits unfair or deceptive acts or practices (UDAP). This applies to all bank messages. Here we review how such communications have resulted in enforcement actions by federal regulators.

In 2015, federal bank regulators cited a bank for UDAP because the bank failed to implement the deposit reconciliation practices stated in its written policies, account opening disclosures, and oral communications with customers.<sup>1</sup> Simply put, the bank's communications did not align with its actual practice.

In other cases, bank communications about loan discounts or deposit account benefits did not align with bank practices<sup>2</sup> or banks miscommunicated information to credit reporting agencies.<sup>3</sup> In a 2017 case, the Federal Reserve issued a UDAP enforcement action concerning discount points on mortgages. Notwithstanding the plain language in several bank

disclosures, many borrowers who paid discount points received no interest rate reduction or a reduction not commensurate with the discount points paid.<sup>4</sup>

Similarly, communications that omit material information can lead to deceptive or unfair practices.<sup>5</sup> In 2018, the Federal Reserve issued a UDAP enforcement action because a bank misrepresented in communications to customers that the full bundle of deposit account add-on product benefits would be available upon enrollment.<sup>6</sup> The bank did not adequately inform customers that they must take action after enrollment to receive some of the benefits. As a result, customers were assessed monthly fees for add-on product benefits even though they could not receive the benefits.

In another enforcement action, in 2019, a bank's communications omitted information material to the customer's understanding of the product.<sup>7</sup> The Federal Reserve cited deceptive practices for misleading bank communications about how deposit account add-on products operated and their benefits. For example, the bank incorrectly informed customers that a tool would automatically monitor customers' deposit accounts

for fraudulent transactions. However, customers had to review their deposit account transactions each day to identify and report fraudulent transactions before 2:00 p.m. The bank also failed to inform customers of an additional step the customer had to complete online to receive the product's benefits.

The Federal Reserve has also addressed practices involving third-party vendors. In 2014, 2015, and 2016, the Federal Reserve issued UDAP enforcement actions because banks' vendors misled students about options and costs associated with financial aid disbursements through the vendor's debit card under the names of both the banks and students' schools.<sup>8</sup> The enforcement actions specifically addressed communications that misled students about fees and other deposit account terms.<sup>9</sup> The lesson is that banks are responsible for communications made on their behalf by their vendors.

Inaccurate or misleading communications by the bank or its vendor present consumer compliance risks. Banks should therefore ensure their communications provide accurate and complete information about products, services, and their benefits.

## ENDNOTES

<sup>1</sup> See *In the Matter of RBS Citizens Financial Group, Inc.* (CFPB docket #2015-CFPB-0020, August 11, 2015).

<sup>2</sup> See *In the Matter of The Bancorp Bank*, FDIC-11-698b.

<sup>3</sup> See *In the Matter of Conduent Business Services, LLC*, Administrative Proceeding File 2017-CFPB-0020.

<sup>4</sup> See *In Matter of Peoples Bank*, FRB Docket 17-041-B-SM (November 28, 2017).

<sup>5</sup> See 15 U.S.C. Section 45, Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 U.S.C. Chapter 53.

<sup>6</sup> See *In the Matter of Community Trust Bank, Inc.*, FRB Docket 18-024-B-SM (July 25, 2018).

<sup>7</sup> See *In the Matter of SunTrust Bank*, FRB Docket 19-028-B-SM (November 19, 2019).

<sup>8</sup> See *In the Matter of Cole Taylor Bank*, FRB Docket 14-021-E-SMB and 14-021-CMP-SMB (June 26, 2014).

<sup>9</sup> See *In the Matter of Higher One, Incorporated*, FRB Docket 15-026-E-I and 15-026-CMP-I (December 23, 2015); see also *In the Matter of Customers Bank*, FRB Dockets 15-027-B-SM and 15-027-CMP-SM (December 2, 2016).

bank uses scripts for staff or TSPs, the compliance function may consider periodically assessing whether the scripts are actually in use and, if not, how this affects communication risk.

### *Avoiding Incentives That Blur the Message*

A seemingly clear policy statement may be blurred by monetary or other incentives that convey different messages to bank staff. Instances have been noted in which bank staff does not consistently communicate the provisions in written disclosures or procedures because there are incentives for not doing so. When discussions with staff reveal conflicting bank communications, a bank can consider whether there may be underlying pressures or rewards fostering the inconsistencies.

### *Managing TSP Communications*

Banks are responsible for ensuring their TSP communications comply with federal consumer protection laws and regulations. Banks should monitor TSP communications to customers and communities made on their behalf. In addition to compliance and legal risks, there may also be heightened reputational risk when TSPs use bank branding that results in customers and the community being unable to determine whether their communications are with the TSPs, an affiliated entity, or the bank. TSP contracts can be reviewed to determine whether they reflect bank policies and provide the bank with mechanisms for monitoring and correcting the messages provided to bank customers and communities. Contract

provisions can also be reviewed to determine whether they reflect service levels, as appropriate, and customer information security expectations in alignment with the bank's service culture and risk tolerance. Generally, effective provisions clearly articulate how much control the bank has regarding TSP customer contacts and messaging and how the bank may monitor complaints and conduct oversight activities.<sup>10</sup> This can be particularly important when there are emergencies and natural disasters during which bank communications are vital to its customers.

### **CONCLUSION**

Understanding and managing risks related to bank communications, including communications contingency planning, are essential for an effective consumer compliance program. This article has suggested strategies to help banks strengthen their communications with customers and communities. The bank is responsible for all of its communications, including those conducted through TSPs. The messages sent to customers reflect bank culture and priorities. Banks face significant risks when customer communications are inaccurate, inconsistent, or fail to safeguard customer privacy and comply with the federal consumer protection laws and regulations. Financial institutions should contact their primary regulators with any specific questions. ■

## ENDNOTES

<sup>1</sup> Robert L. Triplett, III, "Understanding How Culture Drives a Bank's Mission," *Consumer Compliance Outlook*, First Issue 2018.

<sup>2</sup> The Fair Credit Reporting Act (12 C.F.R. §1022.42(a)) requires entities furnishing data to consumer reporting agencies to have reasonable policies and procedures for ensuring the accuracy and integrity of the data provided. For more information on these requirements, see Maureen Yap, "Furnishers' Obligations for Consumer Credit Information Under the CARES Act, FCRA, and ECOA," *Consumer Compliance Outlook*, Second Issue 2020; Kenneth Benton, "Furnishers' Compliance Obligations for Consumer Credit Information Under the FCRA and ECOA," *Consumer Compliance Outlook*, Second Quarter 2012; and "Supervisory Highlights Consumer Reporting Special Edition," Consumer Financial Protection Bureau, Issue 20, Fall 2019.

<sup>3</sup> For supervisory observations related to using fintech technology for targeted, Internet-based marketing, see the *Consumer Compliance Supervision Bulletin* (December 2019).

<sup>4</sup> See 15 U.S.C. §45.

<sup>5</sup> Some federal consumer protection law provisions communications that are accurate and not misleading include Regulation M (12 C.F.R. §1013.7(a)); Regulation Z (12 C.F.R. §1026.16(a); 12 C.F.R. §1026.16(d)(5), 12 C.F.R. §1026.16(f), 12 C.F.R. §1026.24(a); 12 C.F.R. §1026.24(i)); Regulation DD (12 C.F.R. §1030.8(a));

Regulation H, Subpart H on Consumer Protection in Sales of Insurance (12 C.F.R. §208.83(b)); Regulation V (12 C.F.R. 1022.54(b)(1)(iv)(G)); and, Fair Debt Collection Practices Act (15 U.S.C. §1692), Regulation Z, (12 C.F.R. §1026.24(d)), closed-end credit "triggering terms" provisions require additional oral or written disclosures when communications state certain product features.

<sup>6</sup> See 12 C.F.R. §1016.10. State laws may contain additional privacy requirements.

<sup>7</sup> See Regulation P and Fair Credit Reporting Act (12 C.F.R. §1022).

<sup>8</sup> SR 20-3/CA 20-2, "Interagency Statement on Pandemic Planning," March 10, 2020, indicates an effective pandemic contingency framework includes plans for communicating with customers, including anticipating how to serve customers when access to institution facilities must be curtailed.

<sup>9</sup> See CA letter 13-22, "Social Media: Consumer Compliance Risk Management Guidance," December 11, 2018.

<sup>10</sup> See CA letter 13-21, "Guidance on Managing Outsourcing Risk," December 5, 2018.

\*Note: The links for the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at [consumercomplianceoutlook.org](http://consumercomplianceoutlook.org).

# THE FEDERAL RESERVE SYSTEM'S OMBUDSMAN AND AMENDMENTS TO THE MATERIAL SUPERVISORY DETERMINATION APPEALS PROCESS\*

BY THE OFFICE OF THE OMBUDSMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

The Board of Governors of the Federal Reserve System (Board) has an Ombudsman's Office that serves individuals and financial institutions affected by the Federal Reserve System's (System) regulatory and supervisory activities. This article provides an overview of the Ombudsman's Office and explains recent amendments to the System's procedures for an institution to appeal a rating or other supervisory action (material supervisory determination [MSD] appeals process).

## THE ROLE OF AN OMBUDSMAN

The term *ombudsman* is Swedish in origin (translating as *representative*). Its function is to assist "individuals and groups in the resolution of conflicts and concerns."<sup>1</sup> The ombudsman profession dates back to 1713, when King Charles XII of Sweden appointed an ombudsman to help promote good governance and conflict mitigation.<sup>2</sup> The role of ombudsmen has continued to evolve from its public sector origins and is now also used in the private sector and academia worldwide.<sup>3</sup> Organizations and businesses that employ ombudsmen include the United Nations, the International Monetary Fund, the American Red Cross, the Inter-American Development Bank, the United States Olympic and Paralympic Committee, American Express, Coca-Cola, Mars Inc., and United Technologies Corporation.

There are different types of ombudsmen, including organizational, advocate, and classical.<sup>4</sup> The Federal Reserve's ombudsman is organizational in nature because it facilitates the informal resolution of concerns or disputes.

## FEDERAL RESERVE'S OMBUDSMAN'S OFFICE

### *Establishment of the Office of the Ombudsman*

In 1995, as required by the Riegle Community Development and Regulatory Improvement Act of 1994 (Riegle Act), the Board established the position of ombudsman. Other financial regulators, including the Consumer Financial Protection Bureau (Bureau), the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency, also have ombudsmen. The Riegle Act directed each federal banking agency to appoint an ombudsman to:

- act as a liaison between the agency and any party with any problem the party may have in dealing with the agency as a result of its regulatory activities; and
- ensure that safeguards exist to encourage complainants to come forward and preserve confidentiality.<sup>5</sup>

## RESPONSIBILITIES OF THE OMBUDSMAN'S OFFICE

The Office of the Ombudsman is guided by four core values: independence, informality, fairness, and confidentiality. The office operates outside of the System's supervisory and regulatory processes and is therefore independent. It is housed within the Office of the Secretary, which is a separate division from the Board's supervisory divisions. Thus, the Ombudsman staff do not report to the supervisory staff.

The Office of the Ombudsman has three major functions. Primarily, it is available to facilitate the fair and timely resolution of complaints related to the System's supervisory and regulatory activities. In performing this function, the Ombudsman's Office most commonly hears from representatives of state member banks (for which the System is the primary federal regulator) about a specific supervisory determination. For example, financial institutions have contacted the Ombudsman's Office about supervisory component and composite ratings; findings in safety and soundness and consumer compliance examinations; timing, process, or other concerns relating to examinations; and the review and approval of pending applications. To help resolve such matters, the Ombudsman's Office works collaboratively with representatives of the supervised institution and with senior staff at the Board or Reserve Bank, as appropriate. In short, the Ombudsman's Office tries to facilitate productive communication and to keep the resolution process on track.

The Office of the Ombudsman also serves as an intake point for whistleblower complaints against supervised institutions or institution-affiliated parties. After receiving such a complaint, the Ombudsman's Office develops a plan for handling the matter based on the specific facts and circumstances. The office generally gathers information from the complainant and shares the information with appropriate Board or Reserve Bank staff. However, if an individual wants to remain anonymous outside of discussions with the Ombudsman's Office, identifying information is not shared.

The Board's general practice is to attempt to resolve problems informally, unless the severity of the problem requires a formal approach. In keeping with this policy, the Office of the Ombudsman typically assists individuals or financial institutions before a formal process is initiated, often obviating the need to use a formal process. Moreover, the Ombudsman's Office can continue to assist an individual or institution in resolving a dispute even if it has escalated to a formal process. The Ombudsman's Office has informally assisted financial institutions while an MSD is pending to

provide information about the process and to help address issues that may arise.

The second major function of the Office of the Ombudsman is to investigate any claim that System staff retaliated against a supervised institution. The Board has a strict policy prohibiting retaliation. The Ombudsman's Office defines retaliation as any action or decision by Board or Reserve Bank staff that causes a supervised institution to be treated differently or more harshly than other similarly situated institutions because the institution has attempted to resolve a complaint by filing an MSD appeal or has used any other Board mechanism for resolving a complaint.<sup>6</sup> Because of the ongoing relationships between financial institutions and the Board, the Office of the Ombudsman recognizes how difficult it can be for an institution to raise retaliation claims and ensures that all such claims are fully investigated. During this process, the Ombudsman's Office collects and reviews relevant documents, interviews witnesses, and consults with Board or Reserve Bank subject matter experts.<sup>7</sup> Throughout the course of an investigation, the Ombudsman's Office also attempts to resolve retaliation claims informally, such as through discussions with the institution that filed the compliance and relevant Board or Reserve Bank staff.<sup>8</sup>

At the conclusion of an investigation, the Office of the Ombudsman determines if retaliation occurred and reports its factual findings and determination to the director of the appropriate Board division, the appropriate Board committee or governor, and the appropriate Reserve Bank officer in charge of supervision.<sup>9</sup> The Ombudsman's Office may also recommend to the appropriate division director that personnel involved in the claim of retaliation be excluded from the next examination of the institution or review that may lead to an MSD. However, the division director will make the final decision regarding any exclusions of System personnel from future examinations.

The third function of the Office of the Ombudsman is to provide feedback on patterns of issues.<sup>10</sup> This function includes reporting to Board members and senior staff on issues that are likely to have a significant impact on the System's missions, activities, or reputation that arise from the Office of the Ombudsman's review of complaints, such as patterns of issues that occur in multiple complaints. This information includes aggregate data and may also include particular issues raised by institutions. To maintain confidentiality, the Office of the Ombudsman does not share any identifying information about an institution, unless expressly authorized to do so by the institution. This reporting function enables the Office of the Ombudsman to share directly with Board members and senior staff the office's perspective based on the concerns of individuals and financial institutions affected by the System's supervisory or regulatory activities.

In addition to performing these three major functions, the Office of the Ombudsman has established safeguards to protect the identity of the individuals and financial

institutions. The Ombudsman's Office also protects the confidentiality of the information it receives; upon request, the email address and phone number are not accessible to anyone other than Ombudsman staff. The Office of the Ombudsman shares identifying and other information with System staff only if the individual or financial institution has explicitly authorized the office to do so, except if disclosure is required by law, in the event of imminent risk of serious harm or in the case of fraud, waste, or abuse.

**THE PROCESS OF WORKING THROUGH ANY DISPUTE OR ISSUE DEPENDS ON A FINANCIAL INSTITUTION'S WILLINGNESS TO CONTINUE WITH THE RESOLUTION PROCESS.**

In sum, the Office of the Ombudsman serves in most instances as an informal resource and advocates for a fair and timely resolution of disputes or concerns. An institution's use of the ombudsman is voluntary. The process of working through any dispute or issue depends on a financial institution's willingness to continue with the resolution process. If a financial institution or individual no longer wants to pursue resolution through the office, it can terminate the process at any time.

### **THE MATERIAL SUPERVISORY DETERMINATION APPEALS PROCESS**

The first part of this article provided a background on the Office of the Ombudsman, while this section discusses the process by which MSDs may be appealed, the role of the office in handling these appeals, and recent amendments to the appeals process. The Riegle Act also directed the federal banking agencies to establish an "independent intra-agency appellate process" for the review of "material supervisory determination[s]" and to ensure that "appropriate safeguards exist for protecting the appellant from retaliation by agency examiners."<sup>11</sup> In response, the Board established an MSD appeals process in March 1995 and an Ombudsman policy in August 1995. The Board recently adopted an amended MSD appeals process and a revised policy, drawing on experience with and feedback on the original policy.<sup>12</sup> The purpose of the revised process is to improve and expedite the appeals process. Highlights of the amendments, which became effective on April 1, 2020, are summarized below.

The original process defined an MSD to include determinations related to examination or inspection composite ratings, the adequacy of loan loss reserves,



and significant loan classifications. The revised process clarifies that Matters Requiring Attention and Matters Requiring Immediate Attention constitute appealable MSDs. Specifically, the revised process states that an MSD includes, but is not limited to, “any material determination relating to examination or inspection composite ratings, material examination or inspection component ratings, the adequacy of loan loss reserves and/or capital, significant loan classification, accounting interpretation, Matters Requiring Attention (MRAs), Matters Requiring Immediate Attention (MRIs), Community Reinvestment Act ratings (including component ratings), and consumer compliance ratings.” The revised process clarifies that it excludes from an appealable MSD any referral of a matter to another government agency. Finally, the revised process continues to exclude any supervisory determination for which an independent right of appeal exists.

The original appeals process consisted of three levels — an initial review panel, an appeal to the president of the Reserve Bank that issued the MSD, and an appeal to the appropriate Governor at the Board. The revised process has only two levels — an initial review panel and a final review panel, both of which have three members. Under the revised process, all appeals are filed with the Office of the Ombudsman. Generally, the initial review panel consists of three Reserve Bank employees, with the option for a Board employee to be appointed as one of the three members in appropriate circumstances. The final review panel must consist of at least two Board employees, at least one of whom must be an officer of the Board at the level of associate director or higher. Members of the review panels must not have been substantively involved in or, directly or indirectly, report to someone else who was involved in the MSD being appealed. Additionally, none of the panel members may be employees of the Reserve Bank whose MSD is being appealed.

Also under the revised, streamlined process, an institution must file an initial appeal within 30 calendar days of receiving the MSD, and the initial review panel will issue a decision within 45 calendar days of the date the appeal is received.<sup>13</sup> An institution must file a final appeal within 14 calendar days of the initial review panel’s decision, and the final review panel will issue a decision within 21 calendar days of the filing of a final appeal.<sup>14</sup>

The revised process also addresses a potential timing conflict between the Prompt Corrective Action (PCA) framework<sup>15</sup> and the original MSD appeals process by expediting the appeals process. If an MSD being appealed relates to or causes an institution to become critically undercapitalized, the appeals process is further expedited. An institution must still file an initial appeal within 30 calendar days of receipt of the MSD, but the initial review panel will issue a decision within 35 calendar days of the date the appeal is received.<sup>16</sup> An institution must file a final appeal within seven calendar days of the initial review panel’s decision, and the final review panel will issue a decision within 10 calendar days of the final appeal filing.

The revised process also defines specific standards of review applicable at each level of the appeal. The initial review panel considers whether the MSD being appealed is consistent with applicable laws, regulations, and policy and is supported by a preponderance of evidence in the record. The initial review panel will make its own supervisory determination and will not defer to the judgment of the Reserve Bank staff who made the MSD being appealed. The initial review panel may, however, rely on any examination work papers developed by the Reserve Bank or materials submitted by the institution if it determines it is reasonable to do so. The final review panel determines whether the initial review panel’s decision was reasonable.

Finally, the Office of the Ombudsman may attend, as an observer, meetings or deliberations relating to the appeal if requested by either the institution or System personnel. Ombudsman staff will also follow up with institutions that have filed an MSD appeal to inquire whether retaliation has occurred. As in the prior policy, the Office of the Ombudsman is the authorized recipient of all retaliation claims made by supervised institutions involving the Federal Reserve.

## CONCLUSION

As explained previously, the three main functions of the Office of the Ombudsman are (1) to facilitate the fair and timely resolution of complaints related to the System’s supervisory and regulatory activities, (2) to investigate any claim that System staff retaliated against a supervised institution, and (3) to provide feedback on patterns of issues. The Ombudsman’s Office staff is dedicated to helping the System and its constituents resolve issues efficiently and effectively. For more information, visit [www.federalreserve.gov/aboutthefed/ombudsman.htm](http://www.federalreserve.gov/aboutthefed/ombudsman.htm), send an email to [ombudsman@frb.gov](mailto:ombudsman@frb.gov), or call 1-800-337-0429. ■

## ENDNOTES

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- <sup>1</sup> See the International Ombudsman Association at [www.ombudsassociation.org/what-is-an-organizational-ombuds](http://www.ombudsassociation.org/what-is-an-organizational-ombuds).
- <sup>2</sup> See C. McKenna Lang, “A Western King and an Ancient Notion: Reflections on the Origins of Ombudsing,” *Journal of Conflictology* 2(2), 2011.
- <sup>3</sup> See Lang, 2011.
- <sup>4</sup> According to the International Ombudsman Association, an organizational ombudsman “serves as a designated neutral within a specific organization and provides conflict resolution and problem-solving services to members of the organization (internal ombuds) and/or for clients or customers of the organization (external ombuds).” An advocate ombudsman typically advocates on behalf of aggrieved individuals or groups, and a classical ombudsman typically investigates claims about government policies and processes and often makes recommendations for redress or policy changes. See [www.ombudsassociation.org/ombuds-faq](http://www.ombudsassociation.org/ombuds-faq).
- <sup>5</sup> See 12 U.S.C. §4806(d)(2). In 2010, when Congress created the Consumer Financial Protection Bureau, it directed the Bureau to appoint an ombudsman to carry out these roles. See also 12 U.S.C. §5493(a)(5).
- <sup>6</sup> “Internal Appeals Process for Material Supervisory Determinations and Policy Statement Regarding the Ombudsman for the Federal Reserve System,” 85 *Federal Register* 15175, 15182 (March 17, 2020).
- <sup>7</sup> See 85 *Federal Register* at 15181.
- <sup>8</sup> See 85 *Federal Register* at 15181.
- <sup>9</sup> See 85 *Federal Register* at 15181.
- <sup>10</sup> See 85 *Federal Register* at 15181.
- <sup>11</sup> See 12 U.S.C. §4806(a),(b)(2).
- <sup>12</sup> See 85 *Federal Register* at 15175.
- <sup>13</sup> The initial review panel may extend the period for issuing a decision by up to 30 calendar days if it determines that the record is incomplete and that additional fact-finding is necessary for the panel to issue a decision.
- <sup>14</sup> The final review panel may extend the period for issuing a decision by up to 30 calendar days if it determines an extension is appropriate.
- <sup>15</sup> For an overview of the PCA framework, refer to section 4133.1 of the Board’s *Commercial Bank Examination Manual*, available at [www.federalreserve.gov/publications/files/cbem-4000-202004.pdf](http://www.federalreserve.gov/publications/files/cbem-4000-202004.pdf).
- <sup>16</sup> This period may be extended by up to an additional seven calendar days if the initial review panel decides that such time is required to supplement the record and consider additional information received.

\*Note: This article is also being published in *Community Banking Connections*, a Federal Reserve System publication focusing on safety and soundness topics.



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>

## THE BENEFITS OF A PROACTIVE COMPLIANCE PROGRAM

administration responsibilities, the breadth of required flood insurance actions, escrow and private mortgage insurance practices, and bank-specific signature practices, among other areas. Deposit processing procedures for check holds and error-resolution items and complaint procedures are also typically in writing. Employees then receive training about the regulatory requirements *and* the institution's policies and procedures to ensure compliance with the regulations. Monitoring and audit practices, along with effective management reporting, should provide the business line, management, and the board with assurances that established policies and practices are being followed and conducted in a compliant manner. In summary, the board and management should implement sound compliance risk management practices appropriate to the institution's size, complexity, and risk profile.

As Merriam-Webster's definition indicates, a proactive CMS also anticipates change. In financial institutions, this occurs through formal or informal change management processes. These processes anticipate and monitor legal, regulatory, product, or service changes and explicitly consider the impact of these changes on institution resources. This allows the institution to engage affected business line and compliance representatives to implement appropriate solutions in advance of the change. Proactive institutions also keep their boards, marketing staff, and other public-facing employees aware of significant change management plans so they can convey critical information to customers during and after implementation. After change initiatives are implemented, especially for significant changes, proactive institutions conduct reviews to ensure the intended outcomes were effectuated.

A critical component of a proactive CMS is an institution's culture and the incentives for compliance, or risk management more generally, that the board and management establish for their employees. The culture "influences decisions and actions taken in response to the challenges and opportunities a bank faces."<sup>4</sup> Culture and incentives can be harnessed to support a proactive compliance program. Your institution's culture can support this accountability by communicating the importance of compliance-related business practices to all employees.

### IS IT WORTH THE TIME AND MONEY TO BE PROACTIVE?

In the short run, an institution implementing a proactive CMS will incur costs, but they do not have to be excessive. Changing internal processes and reinforcing a desired culture can help support a more proactive compliance program without expending significant funds. But more important, these changes provide an excellent return on investment in the long run by helping the bank avoid potentially disruptive

costs associated with corrective actions in unplanned circumstances.

A significant benefit of a proactive compliance function is identifying and preventing possible issues early, when the potential harm to consumers and the costs to rectify the issues are typically lower. This is true for both ongoing operational compliance and for change initiatives with compliance implications. In a proactive compliance function, management and employees increase their knowledge and understanding of the laws and regulations affecting their business areas; therefore, they are more likely to identify and address potential issues. If employees are encouraged to bring forward compliance issues and potential solutions, they will better understand and adhere to procedural, legal, and regulatory expectations. Additionally, having a culture that encourages staff to surface potential compliance issues helps expose management to the challenges experienced by critical business operations. In contrast, an organization that doesn't actively promote compliance, or fails to recognize the value when compliance issues are identified, is less likely to have an employee come forward with an issue in the future — potentially leading to otherwise avoidable or readily correctable issues being overlooked.

### PROACTIVE CMS RECOGNIZED BY THE CC RATING SYSTEM

One major element in the November 2016 revisions to the FFIEC's CC Rating System is that it rewards institutions with a proactive CMS with higher examination ratings than institutions with a reactive compliance culture.

"Strong compliance programs are proactive. They promote consumer protection by preventing, self-identifying, and addressing compliance issues in a proactive manner. Accordingly, the CC Rating System provides incentives for such practices through the definitions associated with a 1 rating."<sup>5</sup>

The CC Rating System's language specifically identifies corrective action and self-identification as a CMS assessment factor that limits consumer harm and prevents the recurrence of violations of laws and regulations, as shown in Table 1. The eight assessment factors for board and management oversight and the compliance program include terminology in the one (1) and two (2) rating definitions that recognize actions associated with proactive compliance. One (1) rating terminology includes terms such as commitment, empowered, accountable, anticipates, engages and prompt, among others. Two (2) rating terminology also speaks to the effectiveness of compliance program oversight and third parties, evaluation of product changes, management of identified risks, responsiveness of training to change, and actions taken following the identification of compliance deficiencies.

# TABLE 1: FFIEC CONSUMER COMPLIANCE RATING SCALE FOR BOARD AND MANAGEMENT OVERSIGHT FACTORS

Board and Management Oversight	
Board and management oversight factors should be evaluated commensurate with the institution's size, complexity, and risk profile. Compliance expectations below extend to third-party relationships.	
Assessment factors to be considered	Corrective action and self-identification
1	Management <b>proactively</b> identifies issues and promptly responds to compliance risk management deficiencies and any violations of laws or regulations, including remediation.
2	Management adequately responds to and corrects deficiencies and/or violations, including adequate remediation, in the normal course of business.
3	Management does not adequately respond to compliance deficiencies and violations including those related to remediation.
4	Management response to deficiencies, violations and examination findings is seriously deficient.
5	Management is incapable, unwilling and/or fails to respond to deficiencies, violations or examination findings.

### EXAMINER OBSERVATIONS OF PROACTIVE CMS

Examiners are in a unique position to review both proactive and reactive CMS and to identify their differences.

Proactive programs:

- receive support from the top of the organization;
- focus on the compliance implications of regulatory, product, or service changes;
- implement preventative and detective controls to identify compliance issues early; and
- investigate compliance issues to fully identify root causes and necessary solutions.

Effective communications throughout the organization, including with the compliance function, the board, and regulatory agencies, is also evident in proactive programs. Table 2 (see p. 12) summarizes examiner observations of specific aspects of a proactive CMS in the context of the FFIEC’s CC Rating System assessment factors. Examiners typically identify one or more CMS assessment factor concerns in more reactive institutions.

### CONCLUSION

A proactive CMS benefits an institution in helping it understand its compliance risk profile and identify potential issues early, when resolution is less costly, disruptive, and potentially harmful to consumers. Establishing a proactive program with support from the board and management recognizes and communicates the benefits of compliance and CMS enhancements and helps to establish a culture of compliance. Although some aspects of a proactive CMS can include explicit costs such as retaining external vendors, many actions involve relatively minor enhancements to existing processes to support a proactive approach and reduce costs in the long run. With the FFIEC’s 2016 rating system explicitly considering the extent to which an institution is proactive, it is worth evaluating if your institution’s CMS is due for a tune up. Specific questions should be addressed to your primary regulator.

**TABLE 2: EXAMINER OBSERVATIONS OF PROACTIVE CMS**

CMS Assessment Factors	Examiner Observations of Proactive CMS
<p><b>Board and Management Oversight</b></p>	<ol style="list-style-type: none"> <li>1. Recognizing and formally communicating the role of employees in mitigating compliance risk, including in performance expectations</li> <li>2. Encouraging employees to bring issues forward, with proposed solutions.</li> <li>3. Monitoring Changes in laws/regulations are monitored to assess the impact to the institution.</li> <li>4. Analyzing industry wide issues to determine if similar issues exist locally.</li> <li>5. Conducting risk assessments to help mitigate risk and enhance controls by adopting sound practices.</li> <li>6. Changing initiatives to identify compliance requirements at the beginning of projects and require sign off on changes prior to implementation.</li> <li>7. Resolving issues promptly and consider redisclosure or restitution to address consumer harm if appropriate</li> <li>8. Notifying bank’s regulators when significant issues are identified to confirm remediation actions are sufficient.</li> </ol>
<ul style="list-style-type: none"> <li>• Oversight and Commitment</li> <li>• Change Management</li> <li>• Comprehension, Identification, and Management of Risk</li> <li>• Corrective Action and Self-Identification</li> </ul>	
<p><b>Compliance Program</b></p>	<ol style="list-style-type: none"> <li>1. Linking training to the regulatory/legal requirement (what) with the rationale (why) and controls (how) to build knowledge.</li> <li>2. Automating controls used to prevent and, when possible, identify errors.</li> <li>3. Monitoring early warning signals, such as patterns of consumer complaints, loan exception trends, and adverse action timeliness or loan tolerance cures to promptly identify and resolve issues.</li> <li>4. Using internal/external reviews to:                             <ol style="list-style-type: none"> <li>a) conduct after major change initiatives and to confirm the resolution of significant internal review or audit findings;</li> <li>b) consider if policy, procedure, or control enhancements are necessary to resolve findings;</li> <li>c) assess the adequacy of training provided to employees; and</li> <li>d) rank findings by significance, include root cause analysis, recommend resolution actions, and require management’s response to the findings.</li> </ol> </li> </ol>
<ul style="list-style-type: none"> <li>• Policies and Procedures</li> <li>• Training</li> <li>• Monitoring and/or Audit</li> <li>• Consumer Complaint Response</li> </ul>	

**ENDNOTES**

<sup>1</sup> See FRAM History.  
<sup>2</sup> See FFIEC Press Release, Uniform Interagency Consumer Compliance Rating System, November 7, 2016.  
<sup>3</sup> See <https://www.merriam-webster.com/dictionary/proactive>.  
<sup>4</sup> See “Understanding How Culture Drives a Bank’s Mission,” *Consumer Compliance Outlook*, First Issue 2018.  
<sup>5</sup> See 2016 Uniform Interagency Consumer Compliance Rating System, p. 23.  
 \*Note: The links for the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at [consumercomplianceoutlook.org](http://consumercomplianceoutlook.org).

## FEDERAL RESERVE BOARD ISSUES ADVANCED NOTICE OF PROPOSED RULEMAKING TO MODERNIZE THE COMMUNITY REINVESTMENT ACT

On September 21, the Board of Governors of the Federal Reserve System (Board) issued an Advance Notice of Proposed Rulemaking (ANPR) that invites public comment on an approach to modernize the Board's regulations that implement the Community Reinvestment Act (CRA) by strengthening, clarifying, and tailoring them to reflect the current banking landscape and better meet the core purpose of the CRA. The ANPR seeks feedback on ways to evaluate how banks meet the needs of low- and moderate-income (LMI) communities and address inequities in credit access.

Congress enacted the CRA in 1977, as part of several landmark pieces of legislation passed in the wake of the civil rights movement intended to address inequities in the credit markets. The Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency have broad authority and responsibility for implementing the statute, which provides the agencies with a crucial mechanism for addressing persistent structural inequity in the financial system for LMI individuals and communities. The statute and its implementing regulations also provide the agencies, regulated banks, and community organizations with necessary structure for facilitating and supporting a vital financial ecosystem that supports LMI- and minority-focused community development.

“By releasing a thoughtful and balanced ANPR and providing a long period for comment, the Federal Reserve is hoping to build a foundation for the banking agencies to come together on a consistent approach to CRA that has the broad support of the intended beneficiaries as well as banks of different sizes and business models,” said Federal Reserve Board Chair Jerome H. Powell.

“The CRA is a seminal piece of legislation that remains as important as ever as the nation confronts challenges associated with racial equity and the COVID-19 pandemic,” said Federal Reserve Board Governor Lael Brainard. “We must ensure that CRA continues to be a strong and effective tool to address systemic inequities in access to credit and financial services for LMI and minority individuals and communities.”

Public comment on the ANPR will assist the Board in refining CRA modernization proposals to:

- Strengthen CRA's core purpose of meeting the wide range of LMI banking needs and addressing inequities in financial services and credit access;



- Address changes in the banking industry;
- Promote financial inclusion by including special provisions for activities in Indian Country and underserved areas, and for investments in Minority Depository Institutions and Community Development Financial Institutions;
- Bring greater clarity, consistency, and transparency to performance evaluations that are tailored to local conditions;
- Tailor performance tests and assessments to account for differences in bank sizes and business models;
- Clarify and expand eligible CRA activities focused on LMI communities;
- Minimize data burden and tailor data collection and reporting requirements;
- Recognize the special circumstances of small banks in rural areas;
- Create a consistent regulatory approach.

The ANPR, a fact sheet, and other supporting documents are available on the Board's website at <http://bit.ly/CRA-ANPR>. In addition, Board staff prepared a memo for the Governors summarizing the ANPR at [bit.ly/cra-memo](http://bit.ly/cra-memo).

Comments can be submitted on the Board's website at <http://bit.ly/reg-comment> or by sending an email to [comments@federalreserve.gov](mailto:comments@federalreserve.gov). When submitting comments, reference Docket R-1723 and RIN 7100-AF94. The comment period closes on February 16, 2021.

# NEWS FROM WASHINGTON: REGULATORY UPDATES\*

**The Consumer Finance Protection Bureau (Bureau) issues a rulemaking proposal to implement a provision in the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) that created a new exemption from the escrow requirement for higher-priced mortgage loans (HPMLs).** On July 22, 2020, the Bureau issued a notice of proposed rulemaking in the *Federal Register* to implement Section 108 of the EGRRCPA (codified at 15 U.S.C. §1693d(c)(2)), which creates an additional exemption for community banks from the requirement to establish escrow accounts for HPMLs. The proposal would amend Regulation Z, which implements the Truth in Lending Act. Specifically, the proposed exemption applies to insured depository institutions or insured credit unions meeting the following requirements:

- the institution has assets of \$10 billion or less (which will be annually adjusted for inflation);
- the institution and its affiliates originated 1,000 or fewer loans (including portfolio and nonportfolio loans) secured by a first lien on a principal dwelling during the preceding calendar year; and
- the criteria to qualify for an HPML exemption in Regulation Z.

The proposed exemption is in addition to the existing HPML exemption under §1026.35(b)(2)(iii) for institutions with less than \$2 billion in assets, that originate no more than 2,000 first-lien, nonportfolio loans, and meet certain other requirements. The comment period closed on September 21, 2020.

**The Bureau issues an interpretive rule providing guidance on how it determines which counties and areas are underserved.** On June 26, 2020, the Bureau published an interpretive rule in the *Federal Register*, effective immediately, providing updated guidance to creditors and other stakeholders involved in the mortgage origination process to clarify how it will use Home Mortgage Disclosure Act (HMDA) data in determining which counties and areas are “underserved” in a given calendar year. The Bureau annually issues a list of rural and underserved counties and areas, which is relevant to the application of various Regulation Z provisions. For example, creditors use the list to identify whether they qualify for the exemption to the requirement to establish an escrow account for higher-priced mortgage loans and whether they are eligible to originate balloon-payment qualified mortgages and balloon-payment high-cost mortgages. Under Regulation Z, an area is underserved in a given calendar year if, based on HMDA data from the previous year, it is a county in which no more than two creditors extended covered transactions secured by first liens on properties in the county five or more times. The

Bureau’s interpretation supersedes the methodology included in the commentary to Regulation Z, which became partially obsolete when certain HMDA data points were modified or eliminated by the Bureau’s 2015 amendments to Regulation C, which implements HMDA. The interpretive rule describes the HMDA data that it will instead use to identify underserved counties and areas.

**The Bureau publishes its Spring 2020 Agenda outlining its regulatory focus for the period between May 1, 2020, and April 30, 2021.** On June 30, 2020, the Bureau published its Spring 2020 Agenda listing regulatory matters on which it expects to focus between May 1, 2020, and April 30, 2021. The agenda is part of the Spring 2020 Unified Agenda of Federal Regulatory and Deregulatory Actions, the planning process for which began months before the COVID-19 pandemic emergency. The agenda outlines proposed or final rules the Bureau issued prior to its publication date, including:

- a final rule amending the Bureau’s Remittance Rule to provide tailored exceptions that permit certain insured institutions to disclose estimates instead of exact amounts to consumers in certain circumstances and also increases the threshold from 100 to 500 remittance transfers annually under which a person is not covered by the Remittance Rule;
- two proposed rules concerning amendments to the qualified mortgage (QM) provisions of Regulation Z, one of which would amend the general definition of a QM to eliminate and replace the 43 percent debt-to-income requirement with a pricing threshold to help determine a loan’s QM status, and the other of which extends the expiration date for a temporary QM category that currently permits loans purchased or insured by one of the government-sponsored enterprises to be QMs to avoid having this temporary provision expire until any proposed amendments to the General QM are finalized; and
- an extension to August 4, 2020, for the public to file comments on a supplemental proposed rule related to time-barred debt disclosures.

The agenda also outlines regulatory activities planned for the remainder of 2020 through spring 2021, including:

- proposing a rule to implement Section 108 of the EGRRCPA (see previous summary of this escrow-exemption proposal);
- publicly releasing in September 2020 an outline of proposals it is considering to implement Section 1071 of the Dodd–Frank Wall Street Reform and Consumer Protection Act, which amended the Equal Credit

\* Links to the announcements are available in the online version of *Outlook* at [consumercomplianceoutlook.org](http://consumercomplianceoutlook.org).

Opportunity Act to require financial institutions to collect, report, and make public certain information concerning credit applications made by women-owned, minority-owned, and small businesses;

- proposing in fall 2020 two new rules under the Home Mortgage Disclosure Act (HMDA) concerning certain data points reported under the 2015 HMDA rule and public disclosure of such HMDA data, in light of consumer privacy interests, respectively;
- taking final action in October 2020 to finalize the May 2019 proposed rule under Regulation F to govern the activities of debt collectors; and
- issuing a proposed rule for a new “seasoning” definition of QM that would create an alternative pathway to QM safe harbor status for certain mortgages when the borrower has consistently made timely payments for a period.

**The Bureau proposes to amend Regulation Z to address the phaseout of the London Interbank Offered Rate (LIBOR) as a benchmark for variable-rate instruments.**

On June 18, 2020, the Bureau issued a proposed rule in the *Federal Register* to amend Regulation Z to address the phaseout of LIBOR as an index for variable-rate consumer credit products. The proposed rule amends certain open- and closed-end provisions of Regulation Z to provide examples of replacement indices for LIBOR indices that meet certain standards. The proposed rule also changes certain requirements for index changes for certain open-end provisions, requires certain change-in-terms notices, and addresses how credit card rate reevaluation requirements apply. The comment period closed on August 4, 2020. Additionally, the Bureau issued a set of Frequently Asked Questions (FAQs) to address other LIBOR transition topics and regulatory questions arising under the existing rule.

**The Bureau issues an interim final rule amending Regulation X to temporarily permit mortgage servicers to offer certain loss mitigation options based on the evaluation of an incomplete loss mitigation application.**

On June 30, 2020, the Bureau published an interim final rule in the *Federal Register* amending Regulation X. Currently, Regulation X generally requires a servicer to obtain a complete loss mitigation application before evaluating a borrower for loss mitigation options. An exception applies for certain short-term loss mitigation options; see 12 C.F.R. §1024.41(c)(2)(iii). In response to the COVID-19 emergency, the interim final rule creates an additional temporary exception to allow servicers to offer certain loss mitigation options without a complete loss mitigation application to

borrowers facing financial hardship because of the COVID-19 emergency. Under the interim final rule, a loss mitigation option may be provided based on an incomplete application if it satisfies three requirements:

- The option allows the borrower to delay paying certain amounts until the mortgage loan is refinanced, the mortgaged property is sold, the term of the mortgage loan ends, or, for a mortgage insured by the Federal Housing Administration, the mortgage insurance terminates;
- For any amounts that the borrower delays paying, interest does not accrue, the servicer does not charge any fee in connection with the loss mitigation option, and the servicer waives all existing late charges, penalties, and fees, after the borrower accepts the loss mitigation option, and
- The borrower’s acceptance of the loss mitigation offer ends any preexisting delinquency on the mortgage loan.

The interim final rule also provides that, if an option is accepted, the servicer is not required to continue the reasonable diligence efforts otherwise required under 12 C.F.R. §1024.41(b)(1) or send an acknowledgment notice otherwise required under §1024.41(b)(2). The interim final rule became effective on July 1, 2020. The comment period closed on August 14, 2020.

**The Bureau issues a compliance aid to address questions arising under the Equal Credit Opportunity Act (ECOA) for creditors participating in the Small Business Administration’s Paycheck Protection Program (PPP).**

On May 6, 2020, the Bureau issued a compliance aid in the form of FAQs to clarify ECOA questions for lenders processing PPP loan applications. The PPP provides incentives for small businesses to retain employees on their payroll and is part of the relief package Congress created in the Coronavirus Aid, Relief, and Economic Security (CARES) Act to address the unprecedented economic disruption resulting from the COVID-19 pandemic. Creditors participating in the PPP have raised novel questions about complying with ECOA’s requirements for notifying credit applicants about the status of their application.

The full FAQs, which address some of the novel questions, are available on the Bureau’s website.

Please note that as of August 8, 2020, the SBA was no longer accepting new loan applications for the PPP.

## CONSUMER FINANCIAL PROTECTION BUREAU

**The Supreme Court holds that the leadership structure of the Consumer Financial Protection Bureau violates the Constitution's separation of powers.** *Seila Law LLC v. Consumer Financial Protection Bureau*, 140 S. Ct. 2183 (2020).

In 2011, many consumer protection regulatory functions were centralized in a newly created agency — the Consumer Financial Protection Bureau (Bureau) — including rulemaking, supervisory, and enforcement authority for certain depository institutions and nonbanks. The Bureau's structure includes a single director appointed for a five-year term, during which he or she may only be removed by the President for "inefficiency, neglect of duty, or malfeasance in office." 12 U.S.C. §§5491(c) (1), (3). In 2017, after the Bureau issued a civil investigative demand to a California law firm, the firm sued to invalidate the demand by alleging that the CFPB's structure was unconstitutional.

The district court and the Ninth Circuit found the Bureau's structure was constitutional and dismissed the lawsuit. On appeal, the Supreme Court reversed, holding that the structure of the Bureau violates Article II of the Constitution, which gives the President the power to supervise and remove those who exercise authority on his behalf with only limited exceptions. The court distinguished prior cases upholding laws that placed restrictions on the removal of agency officers. In particular, the Supreme Court cited certain factors supporting its finding of a separation of powers violation, noting that the Bureau is structured with a single director who can only be removed for cause, rather than a multimember commission with staggered terms; the Bureau has significant powers to issue regulations, and initiate and adjudicate cases; the five-year term of the Bureau director could result in a President being unable to appoint a director and set enforcement and rulemaking priorities; and the Bureau is funded outside of the Congressional appropriations process.

To resolve the constitutional violation, the Supreme Court did not invalidate the entire Bureau, noting that the statute contains a severability clause. Instead, the Supreme Court only invalidated the provision restricting the President's power to remove the director. In response to the Supreme Court's decision, the director of the Bureau published a notice in the *Federal Register* ratifying most of the Bureau's past regulations and actions to "resolv[e] any potential defect in the validity of these actions arising from Article II of the United States Constitution." 85 *Federal Register* 41330 (July 10, 2020).

## FAIR CREDIT REPORTING ACT (FCRA)

**The Ninth Circuit determines that an employer fulfilled the FCRA's disclosure and authorization requirements in obtaining the plaintiff's consumer report for employment purposes.** *Luna v. Hansen & Adkins Auto Transport, Inc.*, 956 F.3d 1151 (9th Cir. 2020). When the plaintiff applied for a position with Hansen & Adkins, he signed two documents: 1) a disclosure, which appeared on a separate sheet of paper, that informed applicants the company may obtain reports about the applicant's previous employment, previous drug and alcohol test results, and driving record, and 2) an authorization, which indicated that an applicant's signature authorized the company or their subsidiaries or agents to investigate previous employment records. The authorization appeared at the end of the application alongside unrelated notices and waivers.

Under the FCRA, an employer may obtain a consumer report of the applicant if it provides a "clear and conspicuous disclosure ... in a document that consists solely of the disclosure, that a consumer report may be obtained for employment purposes" and obtains the applicant's authorization in writing. 15 U.S.C. §1681b(b)(2)(A)(i)-(ii). The class action lawsuit alleged that the defendant's hiring practices violated FCRA's disclosure and authorization requirements.

On appeal, the Ninth Circuit affirmed the district court's summary judgment in favor of the defendant. The court determined that the disclosure was sufficiently "clear and conspicuous" because it appeared in a "reasonably understandable form" that is "readily noticeable to the consumer." The disclosure may also be provided "contemporaneously" with other employment documents. The court further held that the FCRA's standalone requirements apply only to the disclosure requirements — not the authorization requirement.

\* Links to the court opinions are available in the online version of *Outlook* at [consumercomplianceoutlook.org](https://consumercomplianceoutlook.org).



## REGULATION B — EQUAL CREDIT OPPORTUNITY ACT (ECOA)

**The Eleventh Circuit holds that a guarantor lacks standing to sue for an alleged ECOA violation because a guarantor does not fall within the ECOA’s definition of “applicant.”** *Regions Bank v. Legal Outsource*, 936 F.3d 1184 (11th Cir. 2019). The ECOA prohibits creditors from discriminating “against any applicant, with respect to any aspect of a credit transaction . . . on the basis of . . . marital status.” 15 U.S.C. §1691(a)(1). The federal appeals courts are divided whether ECOA’s definition of “applicant” includes a guarantor. See *Hawkins v. Community Bank of Raymore*, 761 F.3d 937 (8th Cir. 2014), *aff’d by an equally divided Court*, 136 S. Ct. 1072 (2016) (“applicant” does not include guarantors) and *Moran Foods, Inc. v. Mid-Atl. Mkt. Dev. Co.*, 476 F.3d 436 (7th Cir. 2007) (same), with *RL BB Acquisition, LLC v. Bridgemill Commons Dev. Grp.*, 754 F.3d 380 (6th Cir. 2014) (“applicant” includes guarantors).

The Eleventh Circuit has now addressed this issue. The case involves a defaulted loan from Regions Bank to Legal Outsource, a law firm whose principal was Charles Phoenix. The default triggered a cross-default clause in another Regions loan to Periwinkle Partners, LLC, which Charles; his wife, Lisa; and Legal Outsource guaranteed. After Legal Outsource defaulted, Regions brought suit against the guarantors. Lisa filed a counterclaim alleging Regions violated ECOA’s prohibition against marital status discrimination by requiring her to guarantee the Legal Outsource’s debt based solely on her marital status. The district dismissed her claim. On appeal, the Eleventh Circuit affirmed, finding that ECOA’s protections only apply to credit “applicants,” which ECOA defines as “any person who applies to a creditor directly for . . . credit . . .” The court noted a guarantor supports a credit application for someone else but does not seek credit for the guarantor himself and therefore is not an applicant protected by ECOA.

While §1002.2(e) of Regulation B specifically defines “applicant” to include “guarantors, sureties, endorsers, and similar parties” for purposes of the spousal signature provisions of 12 C.F.R. §1002.7(d), the court found that under the decision in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), an agency’s interpretive regulation of a statute it is charged with implementing is not entitled to judicial deference if it contradicts the statute. The court found that ECOA’s definition of applicant did not include guarantors and therefore rejected that interpretation in Regulation B. The U.S. Supreme Court subsequently denied a request to review the decision, thereby declining to resolve the split in interpretation of Regulation B among the federal appeals courts listed previously. As a result, this issue continues to present some uncertainty.

## REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

**The Fourth Circuit rejects lawsuit against real estate team for alleged kickback scheme in violation of RESPA §8(b) because the plaintiffs failed to demonstrate they suffered an injury sufficient for standing.** *Baehr v. Creig Northrop Team, P.C.*, 953 F.3d 244 (4th Cir. 2020). The plaintiffs purchased their home in 2008, and their real estate agent said Lakeview Title Company would provide the title insurance. The agent did not disclose that Lakeview paid monthly marketing fees to the agent’s real estate brokerage firm. The plaintiffs’ class action lawsuit alleged that the monthly marketing payments were actually “kickbacks” prohibited under RESPA §8(b), and they were deprived of fair and impartial competition by the alleged scheme.

The Fourth Circuit affirmed the district court’s summary judgment because plaintiffs did not suffer a concrete injury sufficient to establish injury-in-fact sufficient for Article III standing — specifically, “deprivation of impartial and fair competition between settlement service providers” was not deemed to be an “intangible harm” conferring standing under Article III when “untethered from evidence that it increased settlement costs.” Invoking *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540 (2016), the court noted that a mere statutory violation is insufficient to establish concrete injury. The court noted the plaintiffs did not allege any monetary harm, they had no interest in seeking alternative settlement service providers or title agencies (they “set forth no evidence that impartial and fair competition was even relevant to their decision to obtain settlement services” from the title company at issue), and were admittedly satisfied with the services they received. The plaintiffs’ related legal theories were also rejected, including that the real estate brokerage firm owed them a fiduciary duty to remit the kickbacks they received; the court found a fiduciary relationship did not exist under Maryland state law in the circumstances of this case.

## REGULATORY CALENDAR

EFFECTIVE DATE OR PROPOSAL DATE†	IMPLEMENTING REGULATION	REGULATORY CHANGE
01/01/22	Reg. C	Final rule establishing 200 loans as the permanent Home Mortgage Disclosure Act (HMDA) data reporting threshold for open-end lines of credit
11/02/20	12 C.F.R. Part 1041	Final rule delaying the compliance date for mandatory underwriting provisions of the payday lending rule
09/21/20	Reg. BB	Advanced notice of proposed rulemaking seeking comment on framework to modernize the Federal Reserve Board's implementing regulation for the Community Reinvestment Act
08/21/20	Reg. Z	Proposed rule to create the new Qualified Mortgage category for Seasoned Loans
08/04/20	Reg. Z	Proposed rule under the Economic Growth, Regulatory Relief, and Consumer Protection Act to create new exemption from escrow requirements for higher priced mortgage loans
07/22/20	Reg. Z	Proposed rule to extend the sunset date for the temporary GSE QM loan definition
07/21/20	Reg. E	Final rule that permits insured institutions to estimate the exchange rate for a remittance transfer and increases exemption threshold from 100 to 500 remittance transfers per year
07/10/20	Reg. H	Proposed revisions to interagency questions and answers regarding flood insurance
07/01/20	Reg. X	Interim final rule to require servicers to offer COVID-19-related loss mitigation options based on the evaluation of an incomplete loss mitigation application

† Because proposed rules do not have an effective date, we have listed the *Federal Register* publication date.

EFFECTIVE DATE OR PROPOSAL DATE†	IMPLEMENTING REGULATION	REGULATORY CHANGE
07/01/20	Reg. C	Final rule increasing HMDA reporting threshold for closed-end loans from 25 to 100
07/01/20 (most provisions)	Reg. CC	Final rule implementing required adjustments to the Expedited Funds Availability Act's dollar amounts
06/26/20	Reg. Z	Interpretive rule to update the definition of “underserved area” that applies to certain provisions of Regulation Z to reflect amendments to Regulation C on which the definition is based
06/18/20	Reg. Z	Proposed rule to address the effect of the sunset of LIBOR on sections of Regulation Z
05/04/20	Reg. X/Reg. Z	Interpretive rule regarding the application of certain provisions in the TILA-RESPA Integrated Disclosure Rule and Regulation Z Right of Rescission Rules in light of the COVID-19 pandemic
04/28/20	Reg. D	Interim final rule deleting the six-per-month limit on transfers and withdrawals from savings deposits
04/27/20	Reg. E	Interpretive rule that government pandemic relief payments are not subject to prohibition against compulsory electronic fund transfers
03/03/20	Reg. F	Proposed rule requiring debt collectors to disclose when the statute of limitations has expired for the debt they are attempting to collect

† Because proposed rules do not have an effective date, we have listed the *Federal Register* publication date.

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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 pandemic has subsided and events are rescheduled.

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