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Inside

Error Resolution and Liability Limitations Under Regulations E and Z: Regulatory Requirements, Common Violations, and Sound Practices

By Scott Sonbuchner, Examiner, Federal Reserve Bank of Minneapolis

Debit and credit card payments "grew to 131.2 billion transactions with a value of $7.08 trillion in 2018, up 29.7 billion and $1.56 trillion since 2015," according to the Federal Reserve's 2019 Payments Study.[1] Given this large volume of card transactions involving multiple parties, errors can occur that harm consumers. For example, a merchant may inadvertently charge a customer's card twice for the same purchase or unauthorized transactions may occur after a consumer loses a debit or credit card. According to the Consumer Financial Protection Bureau's (Bureau) *2019 Consumer Response Annual Report*, 27 percent of the nearly 30,000 credit card complaints it received involved a "problem with a purchase shown on your statement."[2] The data also show a large number of complaints for unauthorized transactions.

To protect consumers, the Electronic Fund Transfer Act (EFTA), as implemented by Regulation E, requires financial institutions to investigate when a consumer notifies them of an error for an electronic fund transfer (EFT), to communicate the results within specific timelines and correct the error if one is found, and to limit the consumer's liability if the error involves unauthorized transactions. Similarly, the Truth in Lending Act, as implemented by Regulation Z, imposes error resolution requirements and limits consumer liability for credit cards and other open-end credit plans, which differ to a degree from the requirements for EFTs. These obligations may impact multiple departments within the bank, and the error notices may arrive from different channels. Given the complexities involved with these complaints, financial institutions can strengthen compliance and achieve higher levels of customer satisfaction by having a strong compliance management system for complying with these regulatory requirements.

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Error Resolution and Liability Limits for Prepaid Accounts and Foreign Remittance Transfers

By Scott Sonbuchner, Examiner, Federal Reserve Bank of Minneapolis

This issue focuses on error resolution topics. While the lead article "Error Resolution and Liability Limitations Under Regulations E and Z: Regulatory Requirements, Common Violations, and Sound Practices" on the cover reviewed error resolution requirements for non-prepaid debit cards and credit cards, this article discusses the requirements under Regulation E for prepaid accounts and foreign remittance transfers.

Prepaid Accounts

In 2016, the Bureau issued a final rule to fill a regulatory gap in Regulation E's coverage by expanding the scope of covered products to include certain *prepaid accounts*.[1] Under the final rule, prepaid accounts include:

- payroll cards;
- government benefit cards;
- an account labeled or marketed as *prepaid* and redeemable at multiple, unaffiliated merchants or usable at ATMs; and
- an account issued on a prepaid basis in a specific amount or capable of being loaded with funds that can be used at multiple unaffiliate merchants but is not a checking account, share draft account, or negotiable order of withdrawal account.[2]

In 2018, the Bureau amended the rule to modify the error resolution and liability limits for prepaid accounts that are not payroll or government benefit cards, to delay the effective date until April 1, 2019, and to make other changes.[3]

ERROR RESOLUTION AND LIABILITY LIMITS FOR PREPAID ACCOUNTS

Of relevance to this article, the prepaid account rule applies a modified version of Regulation E's limits on the consumer's liability for unauthorized transactions (§1005.6) and error resolution procedures (§1005.11) to certain prepaid accounts.[4] These provisions are codified in §1005.18(e).

Limitations on Liability

For prepaid accounts that are not payroll or government benefit cards, the 2016 final rule generally applied the consumer liability limits in §1005.6. However, the industry expressed concern about the increased risk of fraudulently reported unauthorized transactions for such accounts because they can be purchased and used anonymously. For example, a consumer could make purchases on a general-use, prepaid debit card, and then allege that some or all of the transactions were unauthorized (a practice referred to as *friendly fraud* or *first-party fraud*).[5] Because these cards can be used anonymously, a financial institution may not be able to access information, beyond the transaction history, that could be useful for determining if the transaction was unauthorized. By contrast, if a consumer has a debit card linked to an account at the institution, the institution may be able to access information while investigating a dispute that could help determine if the transaction was unauthorized, including the account history and anti-money-laundering/know-your-customer verification checks.

Limitations on Liability and Error Resolution for Unverified Accounts

To address these concerns, the Bureau amended the rule to provide that the regulation's requirements for liability limits and error resolution for prepaid accounts that are not government benefit or payroll cards apply only if the financial institution:

- has a consumer identification and verification process for its prepaid account program;
- discloses to the consumer the risks of not verifying and registering an account using a notice with language substantially similar to model form A7 in Regulation E; and
- ensures the consumer successfully completes the consumer identification and verification process for the account.[6]

The 2018 amendment further elaborated on these requirements. Specifically, the amendment clarified the following circumstances in which an institution is deemed to have not successfully completed its consumer identification and verification process:

- The institution has not concluded its consumer identification and verification process and has informed the consumer of the risks of not verifying and registering an account using a notice with language substantially similar to model form A7 in Regulation E.[7] Even if the financial institution later verifies the consumer's identity, it is still not required to investigate or apply the liability limitations for transactions that occurred *prior* to verification.[8]
- The institution has concluded the identification and verification process but was unable to verify the account, provided the institution informed the consumer of the risks of not verifying and registering an account using language substantially similar to model form A7 in Regulation E, or[9]
- The institution does not have a consumer identification and verification process, provided it has disclosed its error resolution process and limitations on consumers' liability for unauthorized transfers or, if none, state it does not provide such protections.[10]

BUREAU ISSUES FAQS FOR ELECTRONIC FUND TRANSFERS

As *Consumer Compliance Outlook* was editing this issue, the Consumer Financial Protection Bureau (Bureau) on June 4, 2021, published Electronic Fund Transfer FAQs, a compliance aid that provides eight FAQs on various error resolution issues under the Electronic Fund Transfer Act (EFTA). The Bureau previously published a policy statement about compliance aids in the *Federal Register* that addresses whether they are legally binding and whether they provide a safe harbor to institutions complying with them.

MODIFIED ERROR RESOLUTION REQUIREMENTS

Financial institutions may provide the traditional Regulation E periodic statements or a periodic statement alternative for prepaid accounts. Institutions that provide the traditional periodic statement are subject to the existing timelines for error investigations and consumer liability under §1005.11 and §1005.6, respectively.

However, institutions using the alternative periodic statement are subject to a different timeline for deciding when an error notice is timely and when a consumer is liable for unauthorized transactions. The alternative allows a financial institution to provide the account balance by telephone, an electronic history of 12 months of account transactions, and a written history of 24 months of account transactions upon request. For institutions using this option, a consumer's error resolution request is timely if received by the earlier of:

- 60 days after the consumer electronically accesses the account (provided that the history made available reflected the error), or
- 60 days after the institution sends a written history of the consumer's transactions in which the error is first reflected.[11]

The regulation also provides a safe harbor option in which a financial institution may comply by investigating any notice of error received within 120 days after the transfer allegedly in error was credited or debited to the consumer's account.[12] This option makes it unnecessary for institutions to track when the consumer electronically accessed the account.

As discussed in the companion article in this issue, "Error Resolution and Liability Limitations Under Regulations E

and Z: Regulatory Requirements, Common Violations, and Sound Practices," institutions should not conflate the timing requirement for responding to an error resolution inquiry for non-prepaid debit cards with the limits on a consumer's liability for unauthorized transactions. When a notice of an unauthorized transaction is received after the timing triggers previously discussed, the liability limits under §1005.6 may still apply for unauthorized transactions that occurred *prior* to the cutoff date.[13] If the consumer accessed the account history online that included the disputed transactions, but waited more than 60 days to file a dispute, the consumer's liability depends on whether the unauthorized transaction(s) involved the loss or theft of an access device and when the unauthorized transaction(s) occurred.

EXAMINER INSIGHTS FOR PREPAID CARD ERROR RESOLUTION COMPLIANCE

Regulation E prohibits institutions from imposing fees for the error-resolution process, including charges for documentation and investigation.[14] While institutions generally avoid directly charging fees for error resolution procedures, charging consumers for general customer contact also risks violating this broad prohibition. For example, several prepaid card programs charge fees for calling customer service. However, if a customer calls to inquire about an EFT transaction or assert a Regulation E error, a charge should not apply.

To address this risk, financial institutions can program telephone prompts to help consumers bypass fees when calling with an error notice. Alternatively, sufficiently trained employees will be better enabled to identify calls in which consumers are alleging a Regulation E covered error. Finally, given the high volume of calls at most prepaid calling card centers, adequate monitoring or call sampling would provide an opportunity to monitor this risk on an ongoing basis.

REGULATION E ERROR RESOLUTION FOR FOREIGN REMITTANCE TRANSFERS

Regulation E provides remittance transfers[15] with separate error resolution procedures in §1005.33, which generally govern when the asserted error involves a remittance transfer provider, subject to limited exceptions.[16] In 2016, *Outlook* reviewed the Regulation E requirements for foreign remittance transfers with an extended discussion of error resolution procedures. In the 2016 article, Table 2 summarized the EFT error resolution procedures for remittance transfers by listing which transactions are defined as errors, the elements of an error notice, and the obligations financial institutions must satisfy in responding to an error notice.

Several elements of the remittance transfer error resolution procedures are similar to elements of the general EFT error resolution procedures. In both procedures, the financial institution may avoid investigating the alleged error by choosing to correct the alleged error in the amount or manner alleged. In both procedures, if an error occurred, the institution may not impose a charge related to any aspect of the error resolution process. In both procedures, if an investigation concluded that no error occurred, written notice must be provided to the consumer; if an investigation concluded error occurred, oral notice can be provided.

Despite their similarities, the procedures have at least one significant difference. The error resolution procedures for remittance transfers explicitly require remittance transfer providers to establish policies and procedures designed to ensure compliance with the error resolution requirements. The policies and procedures must include instructions to retain records of senders' error notices (including any supporting documentation) and the remittance transfer provider's findings from investigating the alleged error. Consistent with the general Regulation E retention requirements in §1005.13, the provider must retain these documents for a minimum of two years.

EXAMINER INSIGHTS ON REMITTANCE TRANSFER ERROR RESOLUTION PROCEDURES

In 2019, the Bureau brought a consent order against a non-bank remittance transfer provider.[17] The facts and analysis of the order provide guidance for possible compliance management program enhancements. The remittance transfer provider initially did not have written policies and procedures designed to ensure compliance with the error resolution requirements. The provider later adopted a policy, but it failed to comply with regulatory requirements.

For example, the policy did not define the key terms of a *remittance transfer error* and a consumer's notice of error. It also did not specify the type of investigation required, how to communicate the results of the investigation to the consumer, or the regulatory time limits for conducting the investigation. These deficient procedures contributed to violations of the error resolution requirements for remittance transfers. The

Bureau found that the provider also failed to properly report error investigation results, failed to notify consumers of their rights after an investigation of an error, and even made deceptive representations to consumers that the provider would not be responsible for errors made by payment agents.

To correct its remittance transfer error resolution procedures, the Bureau required the remittance transfer provider to enhance several of its compliance pillars. Consistent with Regulation E requirements, the remittance provider was required to maintain policies and procedures designed to ensure compliance with the error resolution requirements related to remittance transfers. Additionally, the provider had to maintain a compliance management system and conduct training and oversight, reasonably designed to ensure that operations comply with Regulation E remittance requirements. Overall, the facts of this case and the terms of the consent order provide a helpful reminder that the absence of a critical control like effective procedures can have a cascading impact resulting in other violations.

CONCLUSION

With the addition of the prepaid account rule and the large number of transactions conducted with these accounts, it is important that financial institutions understand their obligations under the prepaid account rule in responding to notice of an error and determining a consumer's liability for unauthorized transactions. As discussed in the article, these obligations vary in some ways from the requirements for non-prepaid EFTs. Similarly, errors can occur with the large volume of foreign remittance transfers, so it is important that financial institutions providing this service understand their obligations for error resolution for these transfers. Specific issues and questions related to error resolution and consumer liability for unauthorized transactions should be raised with the institution's primary regulator. ■

Endnotes*

1 See 81 *Federal Register* 83934 (November 22, 2016). In 2018, the Bureau amended the rule to change the effective date, modify the error resolution and consumer liability provisions, and make other changes. 83 *Federal Register* 6364 (February 13, 2018).

2 See 12 C.F.R. §1005.2(b)(3)(i). Prior to the 2016 rule, payroll cards and government benefit cards were already covered under provisions of Regulation E. The 2016 rule modified some of these requirements, and classified both cards as prepaid accounts. Thus, the 2016 prepaid account rule should be understood as modifying the existing requirements for payroll and government benefit cards while creating new protections for the other categories of prepaid accounts. The rule excludes certain accounts from the definition of prepaid account, including gift cards, loyalty cards, and accounts loaded only with funds from a health savings account.

3 See 83 *Federal Register* 6364, 6382 (February 13, 2018). In response to the rule, PayPal sued the Bureau to challenge certain aspects of the rule. In *PayPal, Inc. v. CFPB*, 2020 WL 7773392 (D.D.C. December 30, 2020), a district judge vacated two provisions of the prepaid account rule. The Bureau is appealing this decision. Error resolution and liability procedures are unaffected by the ruling.

4 See §1005.18(e)(3)(i).

5 See 83 *Federal Register* at 6382.

6 See §1005.18(e)(3).

7 See §1005.18(e)(3)(ii)(A).

8 See §1005.18(e)(3)(iii). See also 83 *Federal Register* at 6383 ("[T]he final rule does not require financial institutions to limit liability or resolve errors that occurred prior to verification on accounts that are later successfully verified.")

9 See §1005.18(e)(3)(ii)(B).

10 See §1005.18(e)(3)(ii)(C).

11 See §1005.18(e)(2)(i)(A) and (B).

12 See §1005.18(e)(2)(ii); Comment 18(e)-1.

13 See Comment §1005.11(b)(1)-7.

14 See Comment §1005.11(c)-3.

15 A *remittance transfer* is an international electronic transfer of funds requested by a sender in a state, territory, or possession of the United States to a designated recipient in a foreign country and sent by a remittance transfer provider. 12 C.F.R. §1005.30(e).

16 If an alleged error in a remittance transfer originates from an account in a financial institution that is not the remittance transfer provider, §1005.11 exclusively applies. However, if the financial institution from which the funds are being transferred is also the remittance transfer provider, §1005.33 exclusively applies.

17 See *In the Matter of Maxitransfers Corp.* (Bureau Consent Order, August 23, 2019).

*Note: The links for the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at consumercomplianceoutlook.org.

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Error Resolution and Liability Limitations Under Regulations E and Z: Regulatory Requirements, Common Violations, and Sound Practices

This article reviews the error resolution requirements for Regulations E and Z by cross-referencing *Consumer Compliance Outlook's* (*Outlook*) comprehensive 2012 article on Regulation E's requirements and *Outlook's* 2016 article on Regulation Z's requirements. We then discuss examiner observations and suggest sound practices to help financial institutions comply with these regulations. We also have a companion article on page 2 that discusses Regulation E's error resolution and consumer liability limitations for prepaid accounts, which became effective in April 2019, as well as error resolution for foreign remittance transfers.

REGULATION E ELECTRONIC FUND TRANSFER ERROR RESOLUTION REQUIREMENTS

This section of the article focuses primarily on common violations and sound practices related to Regulation E error resolution requirements. *Outlook* published an article[3] in 2012 that reviewed the procedures for resolving EFT errors and the limits on a consumer's liability for unauthorized transfers. **Tables 1 and 2** summarize the EFT error resolution procedures by listing the transactions defined as errors, the elements of an error notice, and the obligations financial institutions must satisfy in response to an error notice.

EXAMINER INSIGHTS AND COMMON VIOLATIONS

Examiners continue to find violations of Regulation E error resolution requirements during examinations. Here we discuss common violations and the ways institutions can enhance their compliance management programs related to EFT errors.

TABLE 1 – Regulation E Error Resolution Coverage and Notice Requirements for EFTs (excluding prepaid accounts)

Electronic Fund Transfers	
Error Resolution *Coverage*	• EFTs covered by error resolution rules ▫ debit card and ATM transactions ▫ direct deposits or withdrawals ▫ transfers initiated by telephone • Exceptions ▫ checks and wire transfers ▫ modified rules for prepaid accounts • Types of errors covered ▫ unauthorized EFT ▫ incorrect EFT ▫ EFT omitted from periodic statement ▫ computational error for EFT ▫ receipt for an incorrect amount of money from electronic terminal ▫ EFT not identified per §1005.9 or §1005.10(a) ▫ request for documentation under §1005.9 or §1005.10(a) or for information concerning an EFT
Error Notice Requirements	• Oral or written notice must be provided within 60 days after transmitting a periodic statement listing the disputed transactions (can be extended for extenuating circumstances). • Notice identifies consumer's name and account number. • Notice indicates why an error exists and includes information about the error.

Failing to Apply the Limitations on Liability Properly

When a consumer asserts an unauthorized transaction that occurred more than 60 days after the institution transmitted the periodic statement listing the disputed transactions, the institution is not required to follow the error resolution requirements of §1005.11.[4] Examiners have found that some institutions mistakenly believe this timing requirement for error notices *also* applies to the limits on a consumer's liability for unauthorized transactions. However, the Official Staff Commentary for Regulation E clarifies that even when a consumer notifies the financial institution of unauthorized transactions more than 60 days after the institution transmitted the periodic statement listing the unauthorized transactions, the liability limits under §1005.6 still apply for transactions that occurred *prior* to the 61st day.[5] For example, assume a consumer lost his card on January 1, 2021, noticed it was missing the same day, and had unauthorized transactions of $400 occurring on January 2, 2021, which were included on a periodic statement transmitted by the institution on February 5, 2021. The consumer notifies his financial institution of the lost card on April 30, 2021. His liability is limited to $50 for the unauthorized transfers that occurred on January 2, 2021, which is 61 days *prior* to transmitting the statement showing the unauthorized transactions and still within the $50 liability limit for unauthorized transactions occurring within 48 hours of when the consumer learned the card was missing.[6] *Outlook* reviewed the framework in depth in our 2012 article, using multiple tables to illustrate the liability provisions with two examples involving late notices.

Institutions can mitigate this risk by ensuring that their EFT error resolution procedures and training include specific guidance for the added protections afforded to consumers alleging unauthorized transactions. These added protections can be especially important when determining the effect of a late notice of error and when documenting consumers' promptness in reporting the loss or theft of an access device.

Failure to Promptly Initiate an Investigation

Institutions must investigate alleged errors promptly after receiving an error notice containing the information set forth in Regulation E,[7] whether written or oral.[8] While financial institutions may request a written confirmation after receiving an oral notice of error, they still must promptly begin investigating after receiving the oral notice.[9] Additionally, while institutions may require that a notice be provided only to the telephone number or address disclosed by the institution, if the consumer attempts to provide notice in a different manner, the institution must maintain reasonable procedures to refer the consumer to the specific telephone number or address required.[10]

TABLE 2 – Regulation E Error Resolution Requirements for EFTs (excluding prepaid accounts)

Error Resolution for Electronic Fund Transfers	
Required Response Financial institutions must investigate and respond to errors within these time limits	Resolve errors within 10 business days (accounts open more than 30 days); for accounts open 30 days or fewer (new accounts), resolve errors within 20 days, subject to these additional requirements: • Investigation period can be extended by providing consumer with provisional credit. • If so, the financial institution must inform a consumer of the amount and date of provisional credit and provide access to the funds during the investigation. • For provisional credit, the financial institution may extend the investigation period: 45 calendar days after notice (for accounts opened more than 30 days); for new accounts, for debit card point-of-sale (POS) transactions, or EFT transactions outside the U.S., the period can be extended up to 90 calendar days after notice.
Financial institution's obligation when an error has occurred	• If an error is found, correct within one business day • Report the result to the consumer orally or in writing within three business days after completing the investigation. • For provisional credit, notify the consumer the credit has been made final.
Financial institution's obligation when no error has occurred	• Report the result to the consumer within three business days after completing the investigation in writing; • Include a notice of the consumer's right to request the documents used in the investigation; and • Follow one of two alternative procedures in §1005.11(d)(2) and related commentary if financial institution chooses to debit the provisional credit.

An institution does not comply with the prompt investigation requirement if it requires, as a condition for starting the investigation, that consumers provide information not specified in the regulation. Common examples of requests the regulation does not require in a consumer's error notice, and therefore may not be used as a condition to beginning the investigation, include asking a consumer to visit a branch to complete an error notice, requesting that the consumer first try to resolve the dispute with the merchant, or requiring a notarized affidavit or the filing of a police report.[11]

A 2019 Bureau consent order against USAA Federal Savings Bank (USAA) provides additional examples of conduct inconsistent with the regulatory obligation to promptly initiate an investigation. For consumers who notified USAA of a suspected error concerning a payday loan, the bank's procedures directed representatives to warn consumers about potential financial and legal consequences of proceeding with the investigation. Staff informed consumers that if USAA determined that the ACH debit was authorized, consumers would put their USAA membership at risk, they may be ineligible to purchase additional USAA products, and their existing USAA accounts could be closed. The script also stated that it is a federal crime to make a false statement to a bank and doing so is punishable by a fine of up to $1 million or imprisonment for up to 30 years, or both. If the customer still wanted to proceed with the error resolution procedure, the bank required the customer to complete and notarize a written dispute form. The consent order noted that these practices violated Regulation E's requirement to promptly initiate and conduct error resolution investigations.[12]

To help manage this risk, compliance officers can review error resolution procedures for any steps that may delay an investigation and confirm they are consistent with the regulatory requirement for a prompt investigation. Additionally, compliance officers can review the procedures for receiving consumer disputes from different channels to ensure disputes are routed to the correct point of contact. This could include tellers, receptionists receiving incoming calls, and email inboxes for consumer feedback.

Issues with Provisional Credit

Institutions choosing to extend an error investigation period beyond the 10-business day timeframe (or 20 days for new accounts) generally must provide provisional credit within 10 or 20 days, as applicable.[13]

Examiners have seen instances in which provisional credit was not provided in a timely manner or at all. In some cases, the provisional credit covers the alleged error but fails to include interest when an interest-bearing account is involved. Provisional credit should include both the amount of the alleged error and interest, when applicable.[14]

Institutions can mitigate this risk by reviewing error resolution procedures, including provisional credit requirements, to confirm they align with Regulation E and by conducting training. Compliance officers may also benefit from reviewing error resolution logs for any extended investigations in which the bank did not provide provisional credit. For extended investigations in which the bank did not provide provisional credit, the institution can confirm if the circumstances fall within the regulation's provisional credit exceptions, such as when the institution requires, but does not receive, written confirmation of an error.

Not Conducting a Reasonable Investigation

A financial institution cannot deny a consumer's claim of an error without conducting a reasonable investigation, unless it corrects the error as alleged by the consumer. A reasonable investigation includes reviewing relevant information within the institution's records. If this review confirms the error, the claim cannot be denied.

When the alleged error is an unauthorized EFT, the EFTA places the burden of proof on the financial institution to establish the transaction was authorized. Therefore, if the institution cannot establish the disputed EFT transaction was authorized, the institution must credit the consumer's account.[15]

For example, in the *USAA* enforcement action, the Bureau found that when consumers had previously authorized transactions with a merchant that predated a disputed transaction with the merchant, the bank summarily determined an error had not occurred without considering other evidence in its records, including the consumer's error notice. In numerous instances when USAA found no error, the Bureau determined a reasonable review of all relevant information within USAA's records would have validated the error. The consent order noted that an institution's "reviews must include 'any relevant information within the institution's own records,' … and the investigation 'must be reasonable.'"[16]

To mitigate this risk, compliance departments can conduct transaction testing on previously denied error notices. For each previously denied allegation within the selected sample, the institution can confirm that employees reviewed all relevant information within the institution's records and that the findings of the investigation met the institution's burden of proof to establish that an error did not occur. If the transaction testing revealed that it was not adhering to regulatory requirements, the staff handling the investigations can receive additional training on this issue.

Issues When Denying Claims

A financial institution is required to follow specific regulatory requirements if it determines an error has not occurred or an error occurred in a manner or amount different from what the consumer described. Within three business days after completing its investigation, the institution must report its results to the consumer. This explanation of findings must be in writing and disclose the consumer's right to request the documents relied upon to make the denial. Upon consumer request, institutions must provide the documents in an understandable form. Regulators have seen institutions fail to meet these requirements.

The institution must follow one of two options to debit a previously provided provisional credit.[17] Both options require the financial institution to honor checks and preauthorized transfers from the consumer's account (without charge to the consumer for overdrafts that would have been paid had the provisional credit not been debited) for five business days. Under the option in §1005.11(d)(1)(i), the institution debits the amount first, and then provides the consumer notice, which includes a statement that certain items will be honored for five business days after the notification. Under the second option described in Comment 11(d)(1)(ii)-1, the institution provides the notice first, and then debits the amount five business days later. This option is simpler for the institution but also permits the consumer more freedom with the provisional credit during the five days prior to the debit.

Regulators have seen issues when an institution's notice to consumers does not align with its actual practice for debiting provisional credit. This can happen because template language is not accurate or employees are not knowledgeable about bank processes. For example, if the provisional credit is debited immediately upon notice, institutions must notify consumers that third-party payments and preauthorized transfers will be honored for five days. But if an institution uses the alternative option from the Official Staff Commentary to Regulation E, the provisional credit cannot be debited until five days after the notice is provided.

To mitigate these risks, compliance officers can review bank procedures, interview appropriate staff, and review template letters. Procedures and staff practices need to comply with Regulation E and be consistent with the template letters that employees send to consumers. In cases in which misalignment among written procedures, employee practices, and templates exist, consider retraining employees to ensure they follow the bank's practices correctly.

Issues When Correcting Alleged Errors

If, after completing an investigation, an institution determines an error occurred, it must correct the error within one business day and report the results to the consumer within three business days, subject to the liability provisions of §§1005.6(a) and (b). This correction should include, as applicable, a credit for interest and a refund of fees charged by the institution. While reviewing practices for correcting alleged errors, regulators have found issues with institutions failing to provide timely corrections of errors and notices to consumers. Regulators have also found some fact patterns where institutions failed to include lost interest and fees caused by the error (e.g., an error resulted in an overdraft fee) in monetary adjustments provided to consumers.

Compliance officers can mitigate timing and consumer notification issues by properly documenting requirements and training employees. However, in some cases, determining the full amount of an error may be complicated. For instance, employees may need to examine the account and look at transactions that occurred around the same time as the error or to postdate the credit so the account can accrue the interest. Depending on how the bank's systems and accounts are configured, reducing risk may involve more detailed discussions with employees who have a comprehensive understanding of the bank's deposit account systems.

Issues with Making Investigations Final

Once an investigation is completed, a consumer may not reassert the same error. Similarly, the financial institution cannot reopen the investigation or reverse the credit, unless the transaction is a remittance transfer in which the remittance transfer provider has corrected the same error.[18] Regulators have found these situations can be challenging for institutions. For example, if an institution determines an error occurred and credits a consumer's account but later finds that a merchant refunded the consumer or that the transaction was authorized, it cannot reverse the credit.

Steps to help mitigate this risk include educating the appropriate staff about the consumer protections under Regulation E for errors. Depending on a bank's culture, training covering Regulation E can benefit deposit operations employees as much as it benefits compliance staff. Attending the same training together can help ensure different areas understand when the bank's discretion ends and its legal obligations begin.

ERROR RESOLUTION UNDER REGULATION Z: REGULATORY REQUIREMENTS, COMMON VIOLATIONS, AND SOUND PRACTICES

In 2016, *Outlook* reviewed the Regulation Z error resolution requirements for credit card transactions.[19] In this article, we review the regulation's limitations on a consumer's liability for unauthorized transactions with a credit card.

This section summarizes Regulation Z's liability limiting provisions of §1026.12(b). To understand some of the challenges that can arise from this section of Regulation Z, it is valuable to consider the requirements of Regulation Z's billing error resolution procedures.

Tables 3 and 4 summarize Regulation Z's billing error resolution procedures by providing the list of billing errors it covers, the elements of a billing error notice, and the obligations a creditor must satisfy in response to a billing error notice. This section concludes by reviewing two commonly misunderstood requirements from §1026.12(b) limitations on cardholder liability for unauthorized transactions.

REGULATION Z LIMITATION ON LIABILITY FOR UNAUTHORIZED CREDIT CARD CHARGES

Generally speaking, Regulation Z limits a cardholder's liability for unauthorized credit card transactions.[20] But before any liability can be imposed on the consumer, the regulation imposes three threshold requirements a credit card issuer must satisfy:

- The cardholder must have used an accepted credit card, meaning a credit card the cardholder requested or applied for and received, has signed, has used, or has authorized another person to use.
- The card issuer provided adequate notice of the maximum potential liability and described the procedure to provide notice of unauthorized use (e.g., a telephone number, address, or both). These disclosures may be provided on the credit card's initial disclosure, on the credit card itself, or on the periodic statements.
- The cardholder has provided a method to identify the cardholder or authorized user. For example, this may be a signature, photograph, or fingerprint. This means that cardholders cannot be held liable for unauthorized Internet or telephone purchases, if the issuer has not provided a means to identify the cardholder under these circumstances.[21]

When these conditions are satisfied, liability may be imposed on the cardholder for unauthorized use, but only up to the lesser of $50 or the amount charged by the unauthorized use before the issuer was notified. If a state law or an agreement between the cardholder and the card issuer imposes lesser liability than provided in §1026.12(b), then the lesser liability governs.

The regulation defines *unauthorized* as the use of a credit card by someone other than the cardholder without actual, implied, or apparent authority, and from which the cardholder received no benefit. The cardholder may provide notice to the card issuer by taking reasonable steps in the ordinary course of business to provide the issuer with the relevant information about the loss, theft, or possible unauthorized use. The notice may be oral or written and need not reach a specific person.

TABLE 3 – Regulation Z Error Resolution for Credit Cards: Definitions

Credit Cards	
Definition of *Billing Error*	• An unauthorized charge; • A charge listed on the monthly account statement with the wrong amount or date; • A charge for goods or services not accepted or delivered as agreed; • The card issuer's failure to post payments or other credits; • A computational error; • A charge on a monthly account statement where the consumer requests additional information; and • The creditor's failure to deliver the monthly account statement to the consumer's last known address (assuming the creditor has the change of address, in writing, at least 20 days before the billing period ends).
Billing Error Notice Consumers trigger the requirement for financial institutions to follow regulatory procedures for resolving errors when they give notice that complies with these requirements	A *billing error* is a written notice from a consumer that: • Is received by the creditor at the address specified for billing inquiries, no later than 60 days after the creditor sent the first billing statement reflecting the error (the creditor may require in the billing rights statement that the written notice not be made on the payment medium or other material accompanying the periodic statement); • Enables the creditor to identify the consumer's name and account number; • Explains why the consumer believes there is a billing error; and • Includes the type, date, and amount of the error.

EXAMINER INSIGHTS ON REGULATION Z'S CARDHOLDER LIABILITY NOTICE REQUIREMENTS

While both the billing error resolution section and cardholder liability section require the cardholder to notify the card issuer of an unauthorized use of credit, the notice standards for each are different. For the billing error resolution requirements of §1026.13 to apply, the notice must be in writing, received at the address specified for billing, and received no later than 60 days after the creditor transmitted the first periodic statement that reflects the alleged billing error (see **Table 3**). However, the notice requirements for limiting consumer liability are less strict about where to send the notice and the notice can be provided at any time.

Issues with Late Notices

Similar to our earlier discussion under Regulation E for issues with a consumer's liability, some financial institutions have incorrectly applied the billing error notice time limits to all consumer notices of unauthorized use.[22] For the billing error procedures under §1026.13 to apply, consumers cannot provide a billing error notice more than 60 days after the card issuer sent the first billing statement reflecting the alleged error. This may lead some institutions to ignore notices regarding unauthorized use received after the billing error notice time limit. However, while such a notice is ineffective as a billing error notice that would subject the creditor to the error resolution procedures in §1026.13, it may still be an effective notice for the liability limits of §1026.12(b) to apply.

To mitigate this risk, compliance officers can review credit card error resolution procedures to confirm they do not unintentionally instruct employees to dismiss cardholder claims of unauthorized transactions merely because they are received more than 60 days after the card issuer sent the first billing statement reflecting the alleged error. Additionally, the compliance officer may review previously denied billing error investigations to determine if a late notice was one of the reasons for denying previous investigations. If any of those denied billing error investigations alleged an unauthorized transaction, the compliance officer can consider retraining the individuals in charge of the investigations.

Issues with Receiving Notices

Regulation Z allows the consumer to provide notice of an unauthorized transaction in person, by telephone, or in

TABLE 4 – Regulation Z Error Resolution Response Requirements for Credit Cards

Required Response Financial institutions must follow regulatory requirements for time limits of the investigation	• Investigate within two complete billing cycles (but not later than 90 days) after error notice • Conduct a reasonable investigation and may request consumer's cooperation • If not resolved within 30 days, acknowledge within 30 days receipt of notice • While investigating: ▫ consumers may withhold a disputed amount but must pay the undisputed part of bill; ▫ creditor can collect undisputed portions of bill and apply the disputed amount/ finance charges to credit limit; ▫ financial institution cannot report account as delinquent (unless undisputed amounts remain unpaid), accelerate the debt, restrict or close the account.
Actions financial institution must take if error occurred	• Correct billing error and adjust account accordingly. • Explain in writing any corrections made (separately or with periodic statement).
Actions financial institution must take if no error (or different one) occurred	• Explain in writing the amount owed, including finance charges accrued during the investigation, and when it is due. • If payment was in the grace period when notified of error, customer has a grace period to pay the amount owed. • Consumers may request copies of documents used to investigate; • If the amount owed is not paid after the longer of the card issuer's grace period for making payment or 10 days after notice received, a creditor may begin collection and report account as delinquent. • Financial institution may not report account is delinquent if notice during time payment is due indicating any portion of billing error is still disputed, and • If different billing error occurred than one asserted, creditor must correct it and credit account.

writing. Card issuers cannot require that notices reach a specific person or department.[23] Thus, the issuer's challenge is to ensure it is capturing and documenting error notices from all normal business communication channels.

To mitigate the risk of misplacing a notice of unauthorized credit card use, compliance officers can review points of access where a cardholder may provide notice in a normal business manner. Train receptionists to identify calls and walk-ins in which cardholders are alleging unauthorized transactions and instruct them to forward cardholders to the correct department.

While all inbound email boxes are a potential access point, generic email addresses on the institution's website are at elevated risk for receiving notices of unauthorized credit card use. Identifying reasonable access points and training employees who monitor them can limit the risk of missing the notice.

CONCLUSION

The federal consumer protections for debit and credit cards are extensive and complex and can present challenges for compliance departments. We hope this article's review of these requirements along with examiner observations and sound practices can help facilitate compliance. Specific issues and questions related to Regulation E and Z billing error issues should be raised with the institution's primary regulator. ■

Endnotes*

1 See *The 2019 Federal Reserve Payments Study* (Federal Reserve Board, 2019). This is the Board's most recent payment study, which it conducts triennially. The transactions consisted of non-prepaid debit cards (55.4 percent), prepaid debit cards (10.5 percent), and credit cards (34.1 percent). Prior to 2019, prepaid debit cards were generally not subject to Regulation E's error resolution requirements. The Bureau amended Regulation E in 2016 to add these protections for these cards effective in April 2019, subject to certain limitations, which are codified at 12 C.F.R. §1005.18.

2 See *Consumer Response Annual Report:* January 1–December 31, 2019 (Consumer Financial Protection Bureau, 2019).

3 See Kenneth Benton, "Error Resolution Procedures and Consumer Liability Limits for Unauthorized Electronic Fund Transfers," *Consumer Compliance Outlook* (Fourth Quarter 2012).

4 See §1005.11(b)(1). Alternative time limits may apply to government benefit cards and prepaid accounts. See §1005.15(e)(3),(4) (benefit cards) and §1005.18(e) (prepaid cards). These requirements are discussed later in the article.

5 See Comment §1005.11(b)(1)-7.

6 See §1005.6(b)(2)(i): "Timely notice not given. If the consumer fails to notify the financial institution within two business days after learning of the loss or theft of the access device, the consumers liability shall not exceed the lesser of $500 or the sum of … $50 or the amount of unauthorized transfers that occur within the two business days, whichever is less."

7 See §1005.11(b)(1).

8 See §1005.11(c)(1).

9 See Comment §1005.11(c)-2.

10 See Comment §1005.11(b)(1)-6.

11 See Comments §1005.11(b)(1)-2 and 11(c)-2.

12 See *In the Matter of USAA Federal Savings Bank* (Bureau Consent Order January 2, 2019) at pp. 9–13 (citing 12 C.F.R. §§1005.11(c)(1) and .11(a)-(e)).

13 An exception applies under §1005.11(b)(2) if the institution requires written confirmation of an error within 10 days of an oral notice but does not receive it. In that case, the institution may extend the investigation period without providing provisional credit. See Comment §1005.11(b)(2)-1. The regulation requires that the consumer be notified of the written confirmation requirement when the oral notice of an error is made and the institution must provide the address to send the confirmation.

14 See Comment §1005.11(c)-6.

15 See EFTA Section 909(b) codified at 15 U.S.C. §1693.g(b). See also 83 *Federal Register* 6364, 6382 (February 13, 2018) ("Under EFTA section 909(b), the burden of proof is on the financial institution to show that an alleged error was in fact an authorized transaction; *if the financial institution cannot establish proof of valid authorization, the financial institution must credit the consumer's account."*) Emphasis added.

16 See *In the Matter of USAA Federal Savings Bank* (Bureau Consent Order January 3, 2019) at p. 12.

17 See §1005.11(d)(2(i) and (ii).

18 See Comment §1005.33(f)-3. I.

19 See Kenneth Benton, "Credit and Debit Card Issuers' Obligations When Consumers Dispute Transactions with Merchants," *Consumer Compliance Outlook* (First Quarter 2016).

20 See §1026.12(b)(1)(ii).

21 If the card issuer will not be imposing liability on the consumer, it does not have to comply with the disclosure or identification requirements. See Comment 12(b)(2)-1.

22 See Comment §1026.12(b)(3)-3.

23 See §1026.12(b)(3).

* Note: The links for the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at consumercomplianceoutlook.org.

Community Banks and the Fed: Working Together

by William G. Spaniel, Senior Vice President and Lending Officer, and Chantel N. Gerardo, Senior Writing Center Specialist, Federal Reserve Bank of Philadelphia

Community banks and the Federal Reserve have a long-standing relationship through the Fed's supervision and regulation activities, joint community development initiatives, and other important partnerships. The Federal Reserve values the role that community banks play within their local communities and the broader economy, often looking to community bankers for their input to help inform policy and for their service on Reserve Bank boards of directors and System advisory committees. Through all of these efforts, community bankers' intimate knowledge of consumer and community needs provides key insights for regulators and policymakers.

This article discusses some of the ways that community banks and the Federal Reserve have partnered over the years as well as recent initiatives the Federal Reserve has employed to better support community banks.

WAYS COMMUNITY BANKS PROVIDE INSIGHT

Participating on Advisory Committees

One way that community bankers provide insights to the Federal Reserve is through their participation on advisory committees, which serve as forums for community bankers and the Board of Governors (Board) or Reserve Bank staff to have informative conversations about emerging issues. One of these committees is the national Community Depository Institutions Advisory Council (CDIAC), which was established by the Board in 2010 to "provide input to the Board on the economy, lending conditions, and other issues of interest to community depository institutions."[1] Each Reserve Bank also has a local CDIAC made up of representatives from commercial banks, thrift institutions, and credit unions who provide insights and advice to Reserve Bank leadership. Biannually, one representative from each Reserve Bank's local CDIAC meets with the Board to continue conversations at the national level. Through these engagements, local bankers can inform Board staff about matters that are of interest to them. Recently, for example, a discussion about a Bank Secrecy Act/anti-money laundering matter that surfaced during a CDIAC meeting was brought to the attention of Board members who took the conversation into consideration when crafting supervisory guidance, demonstrating how CDIAC conversations can help policymakers.[2]

In addition to the CDIAC, Reserve Bank staffs convene committees based on individual Bank priorities, such as diversity, equity, and inclusion; community development; and the overall economy. Many of these committees have representation from community bankers and other business leaders. For example, the Federal Reserve Bank of Philadelphia's Economic and Community Advisory Council has business leaders from both the private and public sectors to allow for a broad range of perspectives and enhanced collaboration.[3] Discussion topics can range from updates on local and national market conditions to feedback on proposed Reserve Bank initiatives. These local advisory committees are mutually beneficial: Community bankers and business leaders are able to share their experiences, and Federal Reserve staff have opportunities to hear firsthand about emerging concerns within their Districts.

Partnering on Community Development Initiatives

Local community development functions within each Reserve Bank provide another opportunity for Reserve Banks to work closely with community banks. The goal of community development is to promote economic growth and financial stability for low- and moderate-income (LMI) communities and individuals. Key focus areas include housing and neighborhood revitalization, small businesses and entrepreneurship, employment and workforce development, and community development finance. Partnerships between local Reserve Banks and community banks can lead to the creation of programs that meet a critical need within communities and can allow bankers to further develop relationships with the communities they serve.

In addition to partnering with community bankers on community development initiatives, the Federal Reserve oversees financial institutions' compliance with the Community Reinvestment Act (CRA). Feedback from bankers and community members made it clear that CRA regulations needed to be strengthened to better align with the CRA statute. External stakeholders also sought clearer evaluation standards from federal regulators.[4] In September 2020, the Board issued an Advanced Notice of Proposed Rulemaking (ANPR) seeking public comment on modernizing the regulations that implement the CRA.[5] The ANPR includes proposals aimed at addressing inequities in credit access and access to banking services for LMI and other underserved communities, thereby increasing financial inclusion for all communities. The ANPR also aims to provide more certainty about what types of activities qualify for CRA credit and the locations where these activities will qualify, increase transparency in how performance is evaluated and how ratings are assigned, and tailor the evaluation framework and data collection and reporting requirements based on bank size and business strategy. In addition, the proposal recognizes the need to update the regulation to reflect the changes that have happened in the banking industry over time.

The Federal Reserve staff conducted 51 listening sessions with external stakeholders, including community bankers, in late 2020 and early 2021 to discuss the key objectives and policy proposals in the ANPR and to encourage organizations to submit comment letters with their feedback. The ANPR is a prime example of how feedback from external stakeholders, community needs, and public comment can come together to enhance the Federal Reserve's supervision and regulation practices.

> "In addition to conducting risk-focused examinations, the Federal Reserve emphasizes risk management and controls during safety and soundness examinations and inspections …"

ADDITIONAL WAYS THE FED ENGAGES COMMUNITY BANKS

Exploring Emerging Issues

The Federal Reserve also aims to stay apprised of emerging issues for community banks by encouraging research on these issues. Community bankers often support research efforts by providing data and participating in conferences, such as the annual Community Banking in the 21st Century research and policy conference.[6] Recently, the Federal Reserve has begun to focus on innovation and launched a series of "office hours" to facilitate discussions with bankers and answer questions outside of the supervisory process.[7] These office hours, along with standing annual research conferences and forums, demonstrate how community bankers and Federal Reserve staff are able to learn about emerging issues from one another.

In addition to researching and fostering conversations around emerging issues, the Federal Reserve continues to explore ways to be more responsive to community banks. In late 2020, the Federal Reserve developed a System-wide outreach community of practice, which is intended to provide a common framework for leveraging supervisory outreach activities across the Federal Reserve System. Board and Reserve Bank staff who are collaborating on this initiative are in the process of proposing helpful events and additional resources for community bankers, including a technical assistance program that will support both bankers and state supervisors.

Offering Local Supervision and Outreach

Although the Federal Reserve is the central bank of the United States, the 12 Reserve Bank Districts located throughout the country allow supervisory teams to focus on and specialize in regional issues.[8] This approach allows examination teams and analysts to better understand the unique market conditions, geographic distinctions, and needs within communities, which are all considered during supervisory events. Additionally, the local work and understanding of individual communities help inform national efforts and policy discussions.

The localized structure also allows Reserve Bank staff to have more in-person meetings with various stakeholders of a financial institution.[9] Community banks have business models that emphasize relationship building with consumers, and, in turn, Reserve Bank staff aim to build and maintain relationships with community bankers. To that end, Reserve Banks often host outreach events that allow for in-person engagement activities between Reserve Bank and community bank leaders. Similar to the advisory committees, outreach events provide yet another opportunity for community bankers to provide input to Reserve Bank staff.

Federal Reserve outreach has both a local and national focus. For example, Governor Michelle W. Bowman, the first member of the Board of Governors to fill the community bank seat created by Congress, recently began an effort to have one-on-one phone conversations with leaders of state member banks across the nation. These personal interactions are important to maintaining and fostering the Federal Reserve's relationships with financial institutions, as Reserve Bank staff want to serve as a resource for bankers' questions and concerns. Governor Bowman's individual phone calls, in addition to webinars such as Ask the Fed and Outlook Live, are other examples of methods the Federal Reserve uses to understand the challenges and issues that bankers face. The Federal Reserve also provides resources on some of these challenges by publishing resourceful articles in *Community Banking Connections* and *Consumer Compliance Outlook*.

Using Risk-Focused Supervision

Over the years, the Federal Reserve has aimed to employ risk-focused supervision to reduce unnecessary regulatory burden on supervised institutions, including community banks. In conjunction with existing risk-focused supervisory practices, the Federal Reserve began implementing the Bank Exams Tailored to Risk (BETR) program in 2019 for community and regional state member banks.[10] The BETR program focuses on the most important risks faced by banks and uses a data-driven approach to measure these risks and tailor subsequent examination procedures accordingly.[11] This approach allows the Federal Reserve to apply more streamlined examination work programs to banks with lower-risk profiles, meaning fewer hours are spent on the examination. Additionally, supervisory teams are often able to conduct their work offsite, reducing the amount of time spent onsite at an institution.[12]

Consumer compliance examinations are also conducted using a risk-focused approach, as consumer compliance examiners base examination activities on an assessment of an institution's residual risk.[13] This assessment balances the risks inherent in the bank's operations and environment with the strength of the bank's risk management controls. Through careful pre-examination risk assessments, the Federal Reserve can ensure that consumer compliance examination activities focus on the areas of highest risk for each individual institution, which thereby reduces onsite examination time and burden on banks and enhances the efficacy of the supervision program.

In addition to conducting risk-focused examinations, the Federal Reserve emphasizes risk management and controls during safety and soundness examinations and inspections, as these are often critical areas in which management wants to receive feedback. This approach allows supervisory teams to provide assessments on the current conditions of financial institutions while also considering how they can remain well positioned in the future. The emphasis on risk management and controls has also helped community bankers prioritize their own risk management practices. By conducting risk-focused examinations and emphasizing risk management and controls, the Federal Reserve has aimed to strike a balance between reducing unnecessary burden on community bankers and ensuring that bankers are prepared to operate safe and sound institutions.

During the COVID-19 pandemic, the Federal Reserve made several temporary changes to supervisory, regulatory, and reporting practices to better support and reduce unnecessary burden on financial institutions, especially community banking organizations. For example, the Federal Reserve issued examiner guidance in June 2020 to promote flexibility in supervisory practices for institutions and borrowers impacted by the pandemic.[14] The federal bank regulatory agencies also recognized that, due to participation in federal coronavirus response programs, many community banking organizations experienced size increases that could subject them to new regulations or reporting requirements. To address the situation, the federal bank regulatory agencies announced an interim final rule that generally gives community banking organizations until 2022 to "reduce their size or prepare for new regulatory or reporting standards."[15] This emphasis on flexibility and monitoring also allowed for increased conversations with management teams at supervisory institutions about the risks and challenges they were facing during the pandemic. In addition to conversations at the Reserve Bank level, the Federal Reserve hosted 42 Ask the Fed sessions related to the pandemic and the Federal Reserve's response to the pandemic, a large increase in the number of Ask the Fed sessions from previous years.

"Community banks are integral to the Fed's supervisory program and vital to its understanding of local and national economies and conditions."

CONCLUSION

Community banks and the communities they serve continue to be of critical importance to the Federal Reserve. Community banks are integral to the Fed's supervisory program and vital to its understanding of local and national economies and conditions. The Federal Reserve aims to remain responsive to the evolving landscape for community banks through risk-focused and forward-looking supervisory programs. By continuing to focus attention on economic recovery from the COVID-19 pandemic and risk management in the banking sector, the Federal Reserve will continue to foster conversations about emerging issues within the community bank industry and the communities that they serve, enhance communications and outreach at all levels of the organization, and employ forward-looking, risk-focused supervision. ■

Endnotes*

Note: This article was also published in *Community Banking Connections* (Issue 2 2021).

1. For an overview of the CDIAC, visit www.federalreserve.gov/aboutthefed/cdiac.htm.
2. See Scott Zurborg, "CDIAC: One Important Way the Board Takes the Pulse of Community Banks and the Economies They Serve," *Community Banking Connections*, Third Issue 2020.
3. See the Philadelphia Fed's Economic and Community Advisory Council.
4. See Governor Lael Brainard's speech, "Strengthening the CRA to Meet the Challenges of Our Time," presented at the Urban Institute, Washington, D.C., September 21, 2020.
5. See the Board's September 21, 2020, press release. Comments on the ANPR were due on February 16, 2021, and staff are now completing a review of these comment letters.
6. The annual Community Banking in the 21st Century research and policy conference — sponsored by the Federal Reserve System, the Conference of State Bank Supervisors, and the Federal Deposit Insurance Corporation — brings together community bankers, academics, policymakers, and bank regulators to discuss the latest research on community banking.
7. See more about the Innovation Office Hours Series.
8. The Board of Governors delegates supervision and regulation activities to the Reserve Banks, including conducting examinations and inspections.
9. Because of the COVID-19 pandemic, formerly in-person outreach events have shifted to virtual offerings.
10. The BETR program applies to community and regional state member banks and is detailed in Supervision and Regulation (SR) letter 19-9.
11. See Vadim Bondarenko, Chris Henderson, and Matthew Nankivel, "Improved Risk Identification Helps Tailor Examinations to Banks' Risk Levels," *Community Banking Connections*, First Issue 2020.
12. Due to the COVID-19 crisis, examination activity has been conducted fully offsite since June 2020.
13. This approach applies to the supervision of community banking organizations, defined as institutions supervised by the Federal Reserve with total consolidated assets of $10 billion or less, and is detailed in Consumer Affairs (CA) letter 13-19, "Community Bank Risk-Focused Consumer Compliance Supervision Program."
14. From March to June 2020, the Federal Reserve implemented a pause in examinations. This pause allowed supervisory teams to focus on outreach and monitoring efforts to support financial institutions, including understanding the risks associated with the economic environment during the pandemic. See the Board's press release "Supervisory and Regulatory Actions and Response to COVID-19."
15. See the Board's November 20, 2020, press release "Agencies Provide Temporary Relief to Community Banking Organizations."

*Note: The links for the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at consumercomplianceoutlook.org.

A New Way to Connect with the Federal Reserve

Supervision Central

The Federal Reserve System launches a new technology platform to support examination activities and offsite monitoring processes at community and regional organizations.

- Secure Federal Reserve web application for document submission and data exchange
- Centralized location for examination events and ongoing monitoring activities
- Enhanced collaboration between regulatory agencies on joint initiatives
- Modern technology with ongoing improvements planned to meet your needs
- Strong support model with online resources and service desk representatives
- Easier access with login.gov and a newly automated upload experience coming soon

Consumer Financial Protection Bureau Discusses Expectations for Servicers

On April 7, 2021, the Consumer Financial Protection Bureau (Bureau) published a bulletin to discuss its supervision and enforcement priorities for mortgage servicing. 86 *Federal Register* 17897 (April 7, 2021). Because many borrowers will be facing the end of forbearance periods in the coming months and foreclosure moratoriums are expected to end, the Bureau announced that, in supervising servicers, it will focus on the following concerns:

- **Contacting borrowers in forbearance:** The Bureau will monitor whether servicers contact borrowers in forbearance before the end of the forbearance period about their loss mitigation options.

- **Outreach to borrowers:** The Bureau will monitor whether servicers are ensuring that borrowers have necessary information needed to evaluate them for payment assistance.

- **Addressing language access:** The Bureau will examine whether servicers are managing communications with borrowers with limited English proficiency pursuant to the Equal Credit Opportunity Act (ECOA)'s prohibition against discrimination.

- **Evaluating income fairly:** The Bureau will examine, in determining eligibility for loss mitigation options, whether servicers evaluated borrowers' income from public assistance, child support, and alimony, in accordance with ECOA, to the extent the servicer is otherwise required to use income in determining eligibility for loss mitigation options.

- **Service times:** The Bureau will examine whether borrower inquiries are handled promptly and that hold times do not exceed industry averages.

- **Preventing avoidable foreclosures:** The Bureau will examine whether servicers are complying with foreclosure restrictions in Regulation X and other applicable laws.

- **Credit reporting:** The Bureau will focus on whether servicers are complying with the requirements in the Fair Credit Reporting Act to furnish information to the credit bureaus appropriately.

The bulletin became effective on April 7, 2021.

News From Washington: Regulatory Updates*

Federal Reserve Board issues its biennial report on debit card transactions. On May 7, 2021, the Board of Governors of the Federal Reserve System (Board) published its biennial report for 2019 on interchange fee revenue and costs related to debit card transactions, as required by the Dodd–Frank Act. Highlights of the report include:

- U.S. payment card networks processed $79.2 billion debit and general-use prepaid card transactions valued at $3.1 trillion;
- The card-not-present transaction annual volume growth rate rose to 17.9 percent; with an average transaction amount of $61.36, compared with $32.65 for card-present transactions;
- Prepaid-card transaction volume grew by 12.0 percent;
- Interchange fees across all debit and general-use prepaid card transactions totaled $24.31 billion, an increase of 7.4 percent since 2018;
- Fraud losses for all debit and general-use prepaid cards to all parties were $12.40 per $10,000 in transaction value; and
- Merchants absorbed 56.3 percent of losses from fraudulent transactions in 2019, up from 52.8 percent in 2017, while issuers absorbed 35.4 percent, down from 42.5 percent in 2017. Cardholders absorbed the remainder.

Consumer Financial Protection Bureau (Bureau) issues final rule to amend the General Qualified Mortgage (QM) definition and subsequently postpones its mandatory compliance date to October 1, 2022. On December 29, 2020, the Bureau published a final rule in the *Federal Register* to amend the definition of a General QM, which is one option creditors can use to satisfy Regulation Z's ability-to-repay (ATR) requirement for closed-end, dwelling-secured, consumer loans. The amended General QM definition became effective on March 1, 2021, with a mandatory compliance date of July 1, 2021. On April 30, 2021, the Bureau published a notice in the *Federal Register* to extend it to October 1, 2022, as explained next.

The original General QM definition provided that a borrower's debt-to-income (DTI) ratio could not exceed 43 percent. The revised General QM eliminates this restriction and replaces it with priced-based thresholds tiered to the loan amount and lien position. The Bureau found that a loan's price, measured by the spread between the loan's annual percentage rate (APR) and the average prime offer rate (APOR) for a comparable transaction, provides an alternative measure of creditworthiness and can be a strong indicator of a borrower's ability to repay the loan than debt-DTI alone. The Bureau adopted this change to address the January 2021 scheduled expiration of the GSE Patch QM, which provides QM status to mortgage loans eligible to be purchased or guaranteed by the government-sponsored enterprises. The Bureau expressed concern that the expiration of the GSE Patch QM, which permits mortgage loans to borrowers whose DTI exceeds 43 percent, would significantly reduce access to responsible, affordable credit for creditworthy borrowers whose DTI exceeds 43 percent.

Under the final rule for the amended General QM, a first-lien loan in the amount of $110,260 or higher generally qualifies for QM status (assuming the other existing requirements for a General QM are satisfied, such as the product-feature restrictions and points and fees limits) *if the loan's APR does not exceed APOR for a comparable transaction by 2.25 or more percentage points as of the date the interest rate was set.* Higher thresholds apply to subordinate-lien loans, manufactured home loans, and loans with smaller loan amounts. In addition, the rule retains the existing framework for determining if a QM receives a safe harbor or rebuttable presumption for complying with the ATR requirement: First-lien loans with an APR that exceeds APOR by less than 150 basis points, or by less than 350 basis points for a subordinate-lien loan, are deemed to conclusively comply with the ATR requirement (i.e., safe harbor), while loans with spreads in excess of this threshold up to 225 basis points over APOR have rebuttable presumption of compliance with the ATR requirement. The final rule also eliminates the requirement of considering and verifying debt and income using Appendix Q. Instead, a creditor must consider income, assets, debt obligations, alimony, child support, and monthly DTI ratio or residual income in its ATR determination. Creditors are also required to verify income and debt consistent with the general ATR standard. Creditors will receive a safe harbor if they comply with the standards in in the General QM Final Rule or with revised versions of substantially similar manuals.

As noted previously, the amended General QM rule originally carried a mandatory compliance date of July 1, 2021. However, on April 20, 2021, the Bureau published a final rule that extends the mandatory compliance date by 15 months from July 1, 2021, to October 1, 2022. In doing so, the Bureau effectively extends the expiration date for the GSE Patch QM to October 1, 2022, because the expiration date for the GSE Patch was tied by rule to the mandatory compliance date of the revised General QM.

On a separate but related note, the Bureau issued a statement on February 23, 2021, that it may revisit its new QM category for seasoned loans, for which it issued a final rule in December 2020 and became effective on March 1, 2021. The Seasoned QM definition generally provides QM status to loans held in portfolio by the originating creditor (or first purchaser) for a period of at least 36 months if the loans also satisfy certain performance standards and certain other applicable criteria, even if the loans did not qualify as QMs at origination. [If the Bureau chooses to further revise or even revokes the Seasoned QM rule, it expects to consider the status of any loans originated between March 1, 2021, and the rule amending or revoking the Seasoned QM.]

Agencies issue a second set of proposed amendments to the Interagency Questions and Answers (Q&As) Regarding Private Flood Insurance. On March 18, 2021, the Board, the Farm Credit Administration, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Office of the Comptroller of the Currency (OCC) published a proposal in the *Federal Register* to amend their flood insurance Q&As to address compliance questions on the private flood insurance requirements of the Biggert–Water Flood Insurance Reform Act, for which the agencies published an implementing regulation in February 2019. The proposal has 24 Q&As concerning private flood insurance in the areas of mandatory acceptance, discretionary acceptance, and general compliance. The proposal addresses some questions for which the industry has sought guidance. For example, proposed Mandatory Q&A 1 would provide that a lender may decide to *only* accept private flood insurance policies under the regulation's mandatory acceptance provision. Similarly, proposed Mandatory Q&A 9 would address whether a lender may accept a policy with a compliance aid assurance clause on the declarations page without further review. The comment period closed on May 17, 2021. The agencies also proposed other changes to their Q&As on July 6, 2020, and expect to issue one final rule for both proposals.

Agencies request information and comment on financial institutions' use of artificial intelligence. On March 31, 2021, the Board, Bureau, the FDIC, the NCUA, and the OCC (agencies) published a request for information (RFI) in the *Federal Register* seeking information and comments on financial institutions' use of artificial intelligence (AI) in their activities, including fraud prevention, personalization of customer services, and credit underwriting. The RFI lists 17 questions for which the agencies are seeking comment or information, including views on appropriate risk management practices and challenges in developing, adopting, and managing AI. The agencies will use this information to assist in determining whether clarification on AI issues affecting safety and soundness and consumer protection laws and regulations would be helpful. The comment period closed on July 1, 2021.

The Bureau issues an interpretive rule to clarify that the scope of sex discrimination under the Equal Credit Opportunity Act (ECOA) includes sexual orientation and gender identity. Under ECOA, as implemented by Regulation B, creditors cannot discriminate against an applicant in any aspect of a credit transaction on a prohibited basis, which includes sex discrimination. 15 U.S.C. §1691(a)(1); 12 C.F.R. §1002.4(a). In *Bostock v. Clayton County, Georgia,* 140 S. Ct. 1731 (2020), the U.S. Supreme Court held that the federal law prohibiting sex discrimination in employment (Title VII of the Civil Rights Act of 1964) applies to an employee's sexual orientation and gender identity. On March 16, 2021, in response to inquiries from stakeholders, the Bureau published an interpretive rule in the *Federal Register* to address whether *Bostock* affects the interpretation of ECOA because both Title VII and ECOA prohibit sex discrimination. The Bureau noted that ECOA's legislative history indicates that "judicial constructions of anti-discrimination legislation in the employment field are intended to serve as guides in the application of ECOA." The Bureau also cited several court decisions that applied interpretations of Title VII to ECOA. The Bureau concluded the scope of sex discrimination under ECOA includes sexual orientation or gender identity in light of *Bostock*.

The Bureau also clarified that this prohibition includes discriminating based on a perceived nonconformity with sex-based or gender-based stereotypes. For example, the interpretive rule states that sex discrimination occurs "if a small business lender discourages a small business owner appearing at its office from applying for a business loan and tells the prospective applicant to go home and change because, in the view of the creditor, the small business customer's attire does not accord with the customer's gender." The Bureau further clarified that a person's sex does not have to be the only or primary reason for sex discrimination to occur. Finally, the Bureau clarified that Regulation B's prohibition against associational discrimination (i.e., discrimination based on the characteristics of individuals with whom an applicant is affiliated or associates) applies to sexual orientation and gender identity. For example, a lender denying a credit application because the applicant's guarantor is transgendered has engaged in associational discrimination. The interpretive rule became effective on March 16, 2021.

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

On the Docket: Recent Federal Court Opinions*

FAIR CREDIT REPORTING ACT (FCRA)

Eleventh Circuit addresses consumer reporting agency's duties when consumer disputes information in a credit report. *Losch v. Experian Information Solutions, Inc.,* 995 F.3d 937 (11th Cir. 2021). The plaintiff had previously filed for bankruptcy, in which he reaffirmed his mortgage debt to CitiMortgage to retain his house. Nevertheless, the bankruptcy trustee sold the property. After the mortgage servicer sent the plaintiff past due notices, the plaintiff rescinded his debt reaffirmation and discharged the debt. When the plaintiff learned that his Experian credit report still listed a debt of $140,000 to the servicer and a past due balance of more than $10,000, he disputed this information with Experian. In response, Experian asked the servicer to verify the debt, and the servicer responded that the reporting was accurate. The plaintiff sued the servicer and Experian for violating the FCRA. The servicer settled with the plaintiff, while Experian moved to dismiss the case on a summary judgment motion, which the district court granted.

On appeal, the Eleventh Circuit examined whether Experian had reasonably discharged its obligations under the FCRA in preparing reports and reinvestigating disputed information. As a threshold matter, Experian argued that it did not violate the FCRA because the information in the plaintiff's Experian consumer report indicating he owed a mortgage debt was accurate. Experian argued that a bankruptcy discharge enjoins a creditor from collecting a debt but does not expunge it from the debtor's record. The court disagreed, noting that "although a bankruptcy discharge doesn't 'expunge' a debt, Experian's report was still factually inaccurate. Experian didn't just report the existence of a debt but also the balance that [the plaintiff] owed, the amount [the plaintiff] was past due, and how long [the plaintiff] was past due." Thus, the court concluded Experian included inaccurate information in the plaintiff's credit report.

Regarding Experian's investigation of the plaintiff's dispute, the court found that the consumer provided detailed information to show the consumer report was inaccurate, and Experian did not take additional investigative steps beyond having the servicer verify the debt. Thus, the court concluded that a jury could find that Experian was negligent in discharging its obligations to conduct a reasonable investigation and reinvestigation into the disputed information. However, the court rejected the plaintiff's claim that Experian willfully violated the FCRA. The court vacated the district court's summary judgment and remanded the case to the district court for further proceedings.

Editor's note: As *Outlook* was preparing to publish this issue, the U.S. Supreme Court ruled in *TransUnion LLC v. Ramirez*, 141 S. Ct. 2190 (June 25, 2021) that a plaintiff alleging an FCRA violation because his consumer report contains inaccurate information lacks legal standing to file a lawsuit in federal court if the information is not disseminated to a third party. "The mere presence of an inaccuracy in an internal credit file, if it is not disclosed to a third party, causes no concrete harm." *Outlook* will discuss this case in the next issue.

Second Circuit holds that Equifax did not violate the FCRA by reporting a default judgment as "satisfied." *Shimon v. Equifax Information Services LLC,* 994 F.3d 88 (2d Cir. 2021). The plaintiff's lawsuit against Equifax alleged violations of the FCRA because of the way Equifax reported a debt collector's lawsuit on the plaintiff's credit report. When the plaintiff failed to respond to the collection lawsuit in state court, a default judgment was entered. After the debt collector garnished the plaintiff's wages, the parties settled the case. The plaintiff learned that Equifax was still reporting the default judgment on his credit report, describing it as "satisfied." The plaintiff alleged that this description was inaccurate and violated the FCRA because it implied that a judgment remained. The court noted that a consumer report is inaccurate either when "it is patently incorrect or when it is misleading in such a way and to such an extent that it can be expected to have an adverse effect." The court rejected the plaintiff's claim, finding that the reporting of the judgment as satisfied was accurate. The plaintiff also alleged that Equifax violated the FCRA's requirement that consumer reporting agencies disclose the sources of their information because Equifax failed to disclose that LexisNexis supplied the plaintiff's court information. However, the court found the plaintiff did not suffer actual damages as a result. In addition, the court stated that under the FCRA, Equifax could disclose the original source of the reported information as the information source, as opposed to the identity of any contractors, such as LexisNexis, that gathered the information on an agency's behalf. The court therefore affirmed the dismissal and summary judgments of the district court.

FINTECH CHARTER

Second Circuit holds that the New York State Department of Financial Services (DFS) lacks standing to challenge the fintech charter from the Office of the Comptroller of the Currency (OCC). *Lacewell v. Office of the Comptroller of the Currency,* 999 F.3d 130 (2d Cir. 2021). In July 2018, the OCC began accepting charter applications from nondepository fintech companies to become a Special Purpose National Bank (SPNB), subject to the OCC's supervision. In response, the DFS filed a lawsuit alleging that the charter was impermissible because the National Bank Act only permits the OCC to charter depository institutions. In 2019, the district court ruled in favor of DFS. On appeal, the Second Circuit reversed the decision because it determined DFS lacked the standing to challenge the charter.

The court noted that constitutional standing requires a plaintiff to allege (1) an injury in fact, (2) that is fairly traceable to the challenged conduct, and (3) that is likely to be redressed by a favorable court decision. DFS argued it suffered two injuries: that its regulatory power over nondepository fintech companies that obtained the charter would be reduced to the extent the charter preempted New York law, including its usury law regulating interest rates, and that it could lose assessment fees that it charges nondepository fintechs if they became chartered by the OCC. The court found DFS's fear of preemption or other regulatory disruption was speculative because the extent to which the charter disrupted DFS's regulatory powers would depend on the number and type of companies seeking a charter. The court said injury for standing purposes must be actual or imminent, and no company has yet applied for a SPNB charter. The court found DFS's alleged injury for loss of assessment revenue was similarly speculative, stating: "At least until a non-depository fintech that DFS currently regulates — or would otherwise regulate — decides to apply for an SPNB charter, this alleged assessment loss will remain purely 'conjectural or hypothetical,' rather than 'imminent' as the Constitution requires." The court ordered the lawsuit dismissed without prejudice, which would allow DFS to refile it if the OCC begins granting charters.

FEDERAL TRADE COMMISSION (FTC) ACT

Supreme Court rules that §13(b) of the FTC Act only authorizes the FTC to seek injunctive, and not monetary, relief in federal district court. *AMG Capital Management, LLC v. Federal Trade Commission,* 141 S. Ct. 1341 (2021). The FTC sued a payday lender under §13(b) of the FTC Act for engaging in unfair and deceptive acts and practices with respect to the disclosures for its payday loans and sought an injunction and other relief. The lender's disclosures stated that a customer could repay the loan in a single payment, but the fine print provided that the loan would automatically renew unless the customer opted out. The FTC sought $1.27 billion in restitution and disgorgement, which the district court granted. The lender appealed, arguing that §13(b) only allows the FTC to obtain injunctive relief and does not allow restitution. The Ninth Circuit affirmed the district court's rulings, but the Supreme Court reversed the decision. The court reasoned that the explicit statutory language of §13(b) only permitted injunctions, and not monetary relief. The court observed that the FTC still could pursue restitution for consumers in district court under §19 of the FTC Act, but only after the FTC first invoked the administrative procedures of §5 of the FTC Act. The court suggested that if it were too cumbersome for the FTC to proceed under §5 and §19, it should ask Congress to amend the FTC Act. In response to this decision, a member of the House of Representatives introduced H.R. 2668, the Consumer Protection and Recovery Act, which would amend §13(b) to explicitly authorize the FTC to order restitution and other relief.

The court's ruling does not affect the authority of the federal prudential agencies or the Bureau to order restitution for violations of federal consumer protection laws. The prudential agencies derive their restitution authority from §8(b)(6) of the Federal Deposit Insurance Act (12 U.S.C. §1818(b)(6)), which expressly authorizes the agencies to order restitution when a violation unjustly enriches an institution and in certain other circumstances. In addition, some consumer protection laws have their own restitution enforcement provisions, such as §108(e)(2) of the Truth in Lending Act (15 U.S.C. §1607(e)(2)) for certain violations of finance charge and annual percentage rate disclosure requirements. Similarly, the Bureau has specific restitution authority for the laws it enforces under §1055 of the Consumer Financial Protection Act (12 U.S.C. §5565).

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

Regulatory Calendar

Effective Date or Proposal Date†	Implementing Regulation	Regulatory Change
10/01/22	Reg. Z	Final rule to extend the sunset date for the temporary Government-Sponsored Enterprise QM loan definition
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
11/30/21	Reg. F	Final rule creating implementing regulations for the Fair Debt Collection Practices Act
05/10/21	N/A	Federal Reserve Board's statement on role of supervisory guidance
03/18/21	N/A	Agencies issue second proposed amendments to flood insurance questions and answers
03/16/21	Reg. B	Consumer Financial Protection Bureau (Bureau) issues interpretive rule that scope of sex discrimination under ECOA includes sexual orientation and gender identity
03/01/21	Reg. Z	Final rule creating new QM category for Seasoned Loans Note: On February 23, 2021, the Bureau announced "it is considering whether to initiate a rulemaking to revisit the Seasoned QM Final 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
08/04/20	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

† 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
07/21/20	Reg. E	Final rule allowing 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
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 eliminating the six-per-month limit on transfers and withdrawals from savings deposits

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

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2021 Calendar of Events

October 18–22
American Bankers Association Compliance School – Advanced
Emory Conference Center Hotel, Atlanta, GA

December 2–3
The FDIC's 20th Annual Bank Research Conference
Arlington, VA
The event may be held virtually or as a hybrid, as necessary.

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