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The Federal Reserve System's webinar series on consumer compliance topics

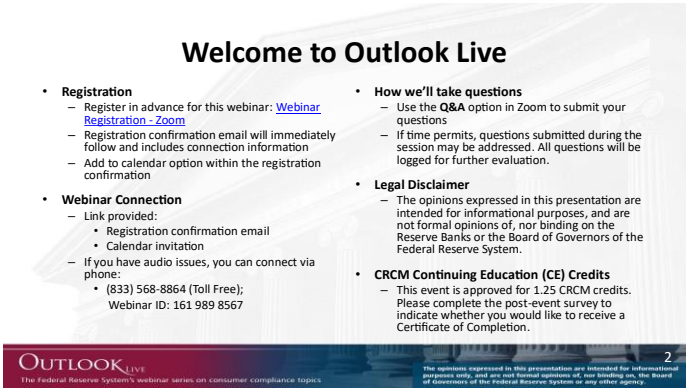
Outlook Live Transcript
Consumer Compliance Requirements for Commercial Products and Services
September 24, 2025

Jean Roark – Facilitator:

Hello and welcome to Outlook Live and to today's session. I'm Jean Roark, and I'm a production consultant in the Center for Learning Innovation at the Federal Reserve Bank of St. Louis. Thank you for joining us. To get us started, I'm going to turn things over to our first speaker.

Beatriz Martinez – Federal Reserve Bank of Chicago:

Hi. Thank you. I'd also like to welcome everyone to today's Outlook Live Webinar, where we will be going over Consumer Compliance Requirements for Commercial Products and Services. Again, my name is Beatriz Martinez, I am a Senior Risk Management Specialist from the Federal Reserve Bank of Chicago, and joining me in this presentation today is Kevin O'Connor, Senior Examiner from the Federal Reserve Bank of Boston.



Before we begin our session, we have a few housekeeping items:

- We are using Zoom for Government today, so thank you for joining us in this virtual space. Hopefully your stream is working, but if it's not, there is a way for you to connect via phone.

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Please use the phone number and ID number provided on the screen to continue listening to the session.

- We do have a Q&A option in this session for questions to be submitted – just enter your questions in the Q&A panel located at the bottom of your Zoom window. We did receive questions ahead of this session and have either addressed them via the presentation or will make sure to answer them as soon as the Q&A portion begins at the end of the presentation. If we do not get to questions submitted during the presentation itself, we will be collecting all questions submitted for evaluation after the session for consideration in future webinars and *Consumer Compliance Outlook* articles.
- For those seeking CRCM credits, this event has been pre-approved for 1.25 CRCM CE credits. Please complete the survey after the session to indicate you would like to receive a CE certificate.
- Before we begin, let me cover the legal language – the opinions expressed in this presentation are intended for informational purposes, and are not formal opinions of, nor binding on, the Reserve Banks or the Board of Governors of the Federal Reserve System.

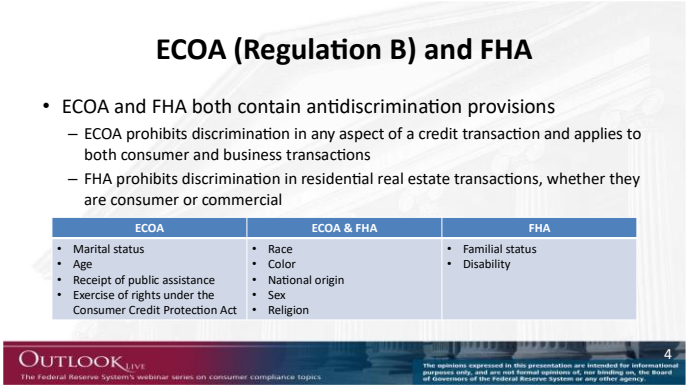
On this slide you will see an overview of today's webinar.

The term "federal consumer protection laws" suggests that the scope of these laws is limited to just consumer products and services. However, some of these laws — such as the Equal Credit Opportunity Act, the Flood Disaster Protection Act, and the Servicemembers Civil Relief Act — also apply to commercial products and services.

Other federal consumer protection laws, although generally limited in scope to consumer products and services, include certain provisions that also apply to commercial products and services. For example, Regulation Z, the implementing regulation for the Truth in Lending Act, includes certain requirements for business-purpose credit cards.

The purpose of this webinar is to provide an overview of these consumer protection laws and the requirements applicable to commercial products and services. This topic was also recently covered in the 2024 First Quarter issue of *Consumer Compliance Outlook*.

Before we begin, you probably noted based on this slide that we will be discussing the Community Reinvestment Act. However, the discussion will be limited to data collection and reporting requirements for small business/small farm loans that are required of large banks under the CRA.



Before diving in, I want to make a quick note about the hyperlinks for the regulatory cites provided throughout the presentation. We are using a combination of links from both the electronic Code of Federal Regulations, or the eCFR, and the CFPB's Interactive Regulations. The Code of Federal Regulations (CFR) is the official source, but in some cases, hyperlinks for the eCFR were not available, which is why we supplemented those with the regulations posted on the CFPB's website.

Now, I'm sure everyone is familiar with the Equal Credit Opportunity Act, or ECOA, and the Fair Housing Act, or the FHA, but as a quick refresher:

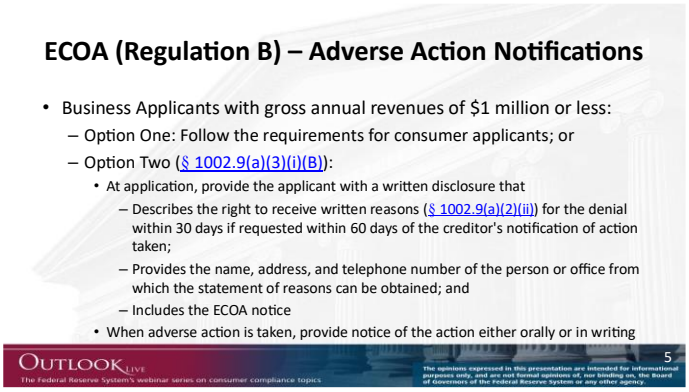
- ECOA, as implemented by Regulation B, prohibits discrimination on a prohibited basis in any aspect of a credit transaction.
- The FHA prohibits, among other things, discrimination in *residential real estate transactions.*
- Both ECOA and the FHA prohibit discrimination on the bases of race, color, national origin, religion, and sex. They also have their own separate set of prohibited basis groups.
- As you can find on this slide, ECOA also prohibits discrimination on the bases of marital status, age, receipt of public assistance, and the applicant's decision to exercise rights under the Consumer Credit Protection Act, while the FHA prohibits discrimination on the bases of familial status and disability.

ECOA and Regulation B's anti-discrimination provisions apply equally to business credit and consumer credit. For commercial credit, sound practices include secondary reviews of denied commercial applications, which does not include the decision maker, to ensure guidelines were followed and that the denial was justified.

While the FHA most frequently involves consumer housing issues, it can apply to certain commercial real estate transactions as well. The FHA defines a *residential real estate transaction* as making or purchasing of loans or providing other financial assistance for purchasing, constructing, improving, repairing, or maintaining a dwelling; or secured by residential real estate; or selling, brokering, or

appraising of residential real property. In the commercial lending context, the FHA's lending requirements apply to a loan to acquire real estate that will be used for residential housing. This would include, for example, a landlord's loan to acquire a residential apartment building or a developer's loan to construct a residential condominium. Note: Because the FHA includes two prohibited bases that are not included in the ECOA — namely, disability and familial status — lenders should ensure their lending decisions and processes are not discriminating against borrowers for commercial loans subject to the FHA.

Now that we've discussed the anti-discrimination provisions of the ECOA and FHA and their applicability to commercial lending, we can discuss the technical requirements of ECOA and their applicability to commercial lending.

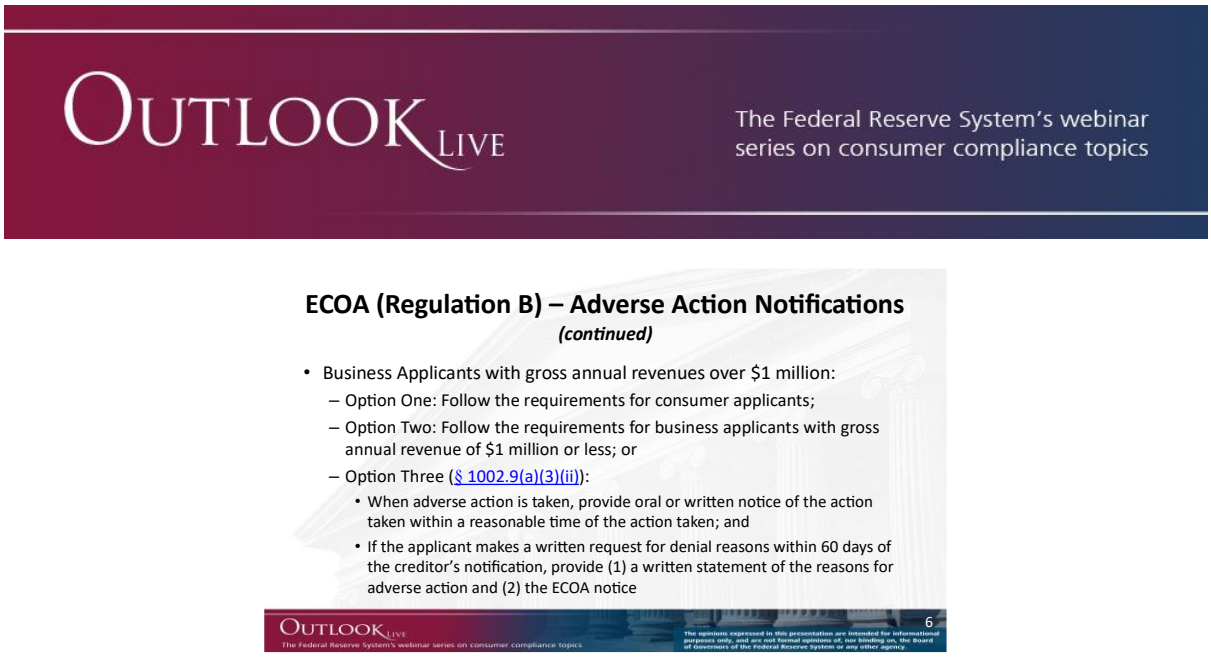


The first technical requirement of ECOA we will discuss is adverse action notification requirements. Although the ECOA and Regulation B apply to both consumer and business credit applicants, the adverse action notice requirements vary when credit is extended to a business. For those who attended our July webinar,[1] these next two slides will look very familiar as our webinar at that time was dedicated specifically to adverse action notifications, but it's also relevant to our current discussion.

For business credit applicants that had $1 million or less in gross revenues during the prior fiscal year, the timing requirements and the contents of the notices are the same as for consumer applicants, although financial institutions may notify the applicants of the adverse action either orally or in writing.

Additionally, a creditor has the option of disclosing at application, instead of after adverse action is taken, the right to request the reasons for the action taken, provided that this disclosure includes the ECOA notice and the applicants' right to a statement of specific reasons for the action taken.

[1] The archive of this event, Adverse Action Notifications – Examiner Insights, is available at: https://www.consumercomplianceoutlook.org/Outlook-Live/2025/Adverse-Action-Notifications/.



For business credit applicants that had more than $1 million in gross revenues, creditors must notify applicants of adverse actions orally or in writing within a reasonable time, as opposed to the 30-day requirement for consumer credit applicants and business credit applicants with $1 million or less in gross revenues.

Creditors must provide a written statement of the reasons for adverse action and the ECOA notice if the applicant makes a written request within 60 days of the creditor's notification.

Providing an adverse action notice (AAN) when a credit decision is based on alternative data can present challenges because in some cases it is not always clear which factor or factors prompted the lender to take adverse action. Alternative data is defined as information not typically found in a consumer's credit report file or that consumers do not customarily provide during applications for credit.

In December 2019, the banking agencies issued the Interagency Statement on the Use of Alternative Data in Credit Underwriting. The statement noted that some creditors are using *alternative data* to evaluate borrowers' repayment ability, including bank account cash flows. The statement also noted the creditors' use of cash flow data can generally be explained and disclosed to the applicant consistent with the adverse action notice requirements in the ECOA.

Appendix C of Regulation B includes sample adverse action notice forms that list some of the factors creditors commonly consider in taking adverse action. However, when a creditor uses alternative data in the credit decision and the application is denied based on that data, the factors listed in the Appendix C forms may not be suitable. Appendix C states that if reasons commonly used by the creditor are not provided on the form, the creditor should modify the checklist by substituting or adding other reasons. This flexibility may be useful when applying the adverse action notice requirements to denied applications based on alternative data.

Adverse Action Notice requirements are often identified as regulatory violations, so, as a sound practice, it is important to ensure that your institution adheres to the requirements and employs practices to mitigate the risk of such violations, such as appropriate policies and procedures, secondary reviews, and training.

The second technical requirement of ECOA we will discuss is the spousal signature rule.

Before discussing spousal requirements in connection with commercial credit, it is helpful to first note the core requirements. When an applicant applies for credit individually and meets the creditor's lending standards for the amount and credit terms requested, the creditor cannot require the signature of an applicant's spouse or other person, other than a joint applicant, on any credit instrument, subject to certain exceptions.

To implement this requirement, the regulation requires that when spouses apply for credit jointly, their intent to do so must be evidenced at the time of application. Joint signatures on a promissory note are insufficient for this purpose. However, the staff commentary further states that "signatures or initials on a credit application affirming applicants' intent to apply for joint credit may be used to establish intent to apply for joint credit."

For commercial credit, a creditor may require the personal guarantee of the partners, directors, or officers of a business, as well as the shareholders of closely held corporations, even though the business independently meets the creditor's lending standards for the amount and terms requested. Creditors must base this decision on the guarantor's relationship to the business and not on a prohibited basis, such as requiring guarantees only for women-owned or minority-owned businesses or requiring guarantees only of the married officers of a business or the married shareholders of a closely held corporation.

Spousal signatures are also often identified as regulatory violations. As a sound practice, it is important to ensure adherence to the requirements and employ practices to mitigate the risk of such violations, such as policies and procedures that clearly describe how documentation indicating joint intent is to be captured, secondary review of such documentation, and loan officer training.

Scenario – Spousal Signatures

- Business A submits a loan application to improve a residential rental duplex and provides a corporate resolution listing one officer. The bank requires a spousal guarantee from the officer even though Business A is creditworthy. Select the best answer:
  1. The bank can request a spousal guarantee because the loan is covered by the FHA and marital status is not an FHA-prohibited basis.
  2. The bank can request a spousal guarantee regardless of ownership because Regulation B allows a spousal guarantee for a business loan.
  3. The bank cannot specifically request a spousal guarantee.

Let's go over a quick scenario. Business A completes an application to improve a rental duplex. Business A provides a corporate resolution listing one officer. The bank requires a spousal guarantee from the officer even though Business A is creditworthy. Select the best answer:

1. The bank cannot request a spousal guarantee because the loan type is not covered by FHA.
2. The bank can request a spousal guarantee regardless of ownership because it is allowed by Regulation B for this type of loan.
3. The bank cannot automatically request a spousal guarantee.

Scenario – Spousal Signatures Response

- The bank cannot specifically require a spousal guarantee. While the loan is covered by FHA, which does not include marital status as a prohibited basis, the loan is *also* subject to Regulation B, which includes marital status as a prohibited basis. The spousal signature rules in § 1002.7(d) prohibit a creditor from requiring the signature of a guarantor's spouse just as they bar the creditor from requiring the signature of an applicant's spouse. (comment 7(d)(6)-2)
- But note: a creditor may require Business A to provide a guarantor for the loan, and the spouse of an officer of Business A may permissibly offer to be a guarantor. The distinction is that the lender cannot *require* the guarantor to be a spouse of the officer, which is discrimination based on marital status.

The correct answer is #3: the bank cannot automatically request a spousal guarantee. While the loan type is covered by FHA, this restriction is related to Regulation B. The rules bar a creditor from requiring the signature of a guarantor's spouse just as they bar the creditor from requiring the signature of an applicant's spouse.

Other ECOA (Regulation B) Provisions

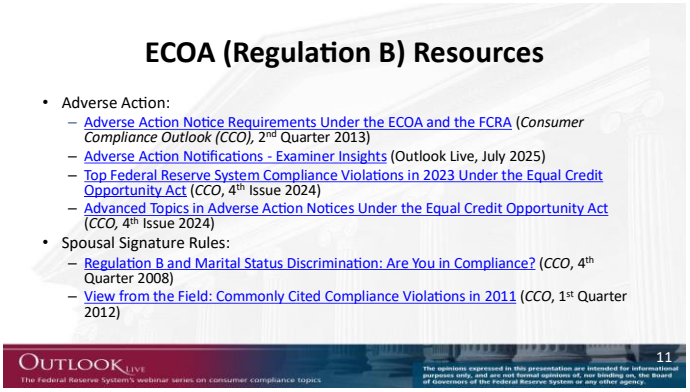
- Other technical requirement reminders:
  - Creditors must provide copies of all appraisals and other written valuations for credit secured by a first lien on a dwelling (§ 1002.14(a)(1))
  - Creditors must retain written or recorded information for commercial credit applications for 12 months (§ 1002.12(b)(1))
  - Statute of limitations for a private right of action is five years or within one year after the commencement of an administrative enforcement proceeding brought by the Attorney General of the United States within five years after the alleged violation (§ 1002.16(b)(2))

This slide includes several additional technical Regulation B requirements.

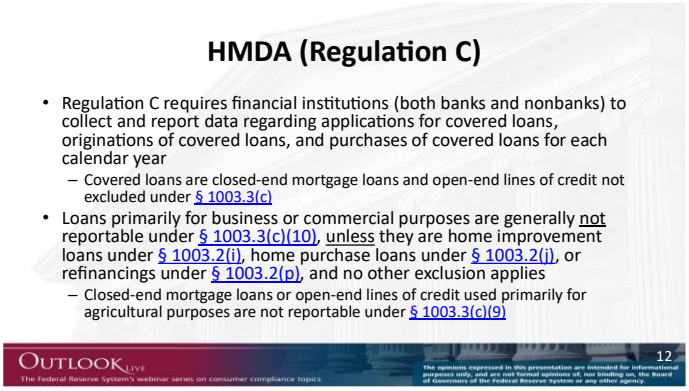
The first involves appraisals. Regulation B requires a creditor to provide an applicant with a copy of all appraisals and other written valuations developed in connection with an application for credit that is to be secured by a first lien on a dwelling. This section of Regulation B defines a dwelling as a residential structure that contains one to four units whether or not that structure is attached to real property. For these applications, a creditor must also mail or deliver to an applicant, not later than the third business day after the creditor receives an application for credit that is to be secured by a first lien on a dwelling, a notice in writing of the applicant's right to receive a copy of all written appraisals developed in connection with the application. As you can see from these requirements, there may be situations where a commercial loan would be subject to the appraisal requirements of Regulation B.

Another technical requirement involves record retention. Regulation B generally requires creditors to retain written or recorded information in connection with a commercial credit application for 12 months after the date that the applicant learned of the action taken on the application. This is in comparison to 25 months for consumer credit applications.

Lastly, there are also technical requirements regarding the statute of limitations for ECOA lawsuits. The Dodd–Frank Act extended the statute of limitations for ECOA claims from two to five years. As a result, creditors have longer exposure to civil legal liability for consumer and commercial credit transactions.



Here we wanted to provide a list of helpful resources to find guidance on the ECOA requirements discussed today.



Continuing with other consumer protection laws, we are now going to discuss the Home Mortgage Disclosure Act, or HMDA, implemented by Regulation C.

What is reportable and what is not reportable under the HMDA can be tricky, and sometimes banks make the mistake of thinking that commercial or business-purpose loans are not reportable. As such, they don't have the same processes, training, and controls in their commercial lending business lines to adequately prevent and detect violations.

The big picture here is that banks are required to collect and report data on commercial loans in certain circumstances, so banks cannot simply exclude them from coverage simply because they are business purpose, or because they come in through a business or commercial lending division of the bank vs. the mortgage lending division of the bank.

To help clarify HMDA's requirements, taking a step-by-step approach can help banks determine whether certain commercial applications and loans are reportable. To determine whether a transaction is reportable, first determine whether the transaction is a covered loan. Regulation C requires banks to collect data regarding applications for covered loans that it receives, covered loans that it originates, and covered loans that it purchases for each calendar year.

A "covered loan" is a closed-end mortgage loan or an open-end line of credit that is not an excluded transaction. For HMDA reporting, we are focused on both types of loans. The important aspect of each of these loans is that they must be secured by a "dwelling," meaning a "residential structure, whether or not attached to real property."

The second step to determine if a transaction is reportable, determine whether the covered loan is an “excluded transaction.” So, what is an excluded transaction?

There are several transactional exclusions, but we will focus on loans made primarily for a business or commercial purpose. These loans are “excluded transactions,” therefore not a covered loan and subsequently not a reportable loan. However, if the loan is for home improvement, home purchase, or a refinancing, the loan falls within the definition of a covered loan and is therefore reportable.

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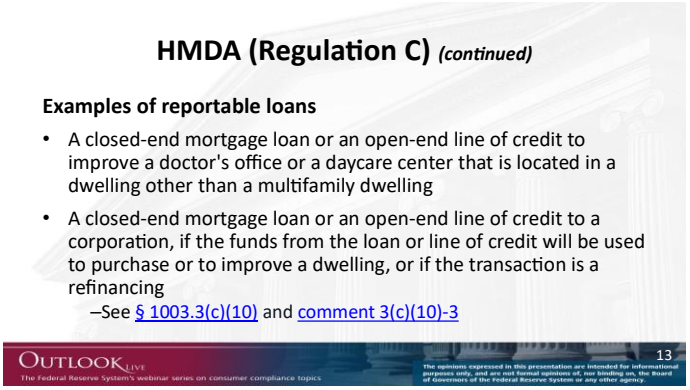
The FFIEC's A Guide to HMDA Reporting: Getting It Right! (Guide)[2] is a valuable resource that can help you determine whether loans are subject to HMDA reporting, but we want to provide a quick refresher on home improvement, home purchase, and refinancing commercial loans subject to HMDA.

A home improvement loan means a covered loan that is for the purpose, in whole or in part, of repairing, rehabilitating, remodeling, or improving a dwelling or the real property on which the dwelling is located. In the context of a commercial loan, a home improvement loan may include a loan originated outside a bank's residential mortgage lending division, such as a loan or line of credit to improve an apartment building originated in the commercial loan department (*see* Comment 2(i)-3). While this may be a commercial purpose loan, it is reportable as a home improvement loan.

A home purchase loan is a loan that is for the purpose, in whole or in part, of purchasing a dwelling. In the context of a commercial loan, a home purchase loan may include a closed-end mortgage loan or an open-end line of credit originated outside the bank's residential mortgage lending division, such as a loan or line of credit to purchase an apartment building originated in the commercial loan department (*see* Comment 2(j)-2).

A refinancing means a closed-end mortgage loan or an open-end line of credit in which a new, dwelling-secured debt obligation satisfies and replaces an existing, dwelling-secured debt obligation by the same borrower (*see* Comment 2(p)-1).



This slide includes examples of reportable loans. Although they are primarily for a business or commercial purpose, they also meet the definition of a home improvement loan, a home purchase loan, or a refinancing, and thus do not qualify for exclusion and are therefore reportable.

The first example is a loan to improve a doctor's office or a daycare center that is located in a dwelling other than a multifamily dwelling.

[2] The Guide is available at: https://www.ffiec.gov/data/hmda.

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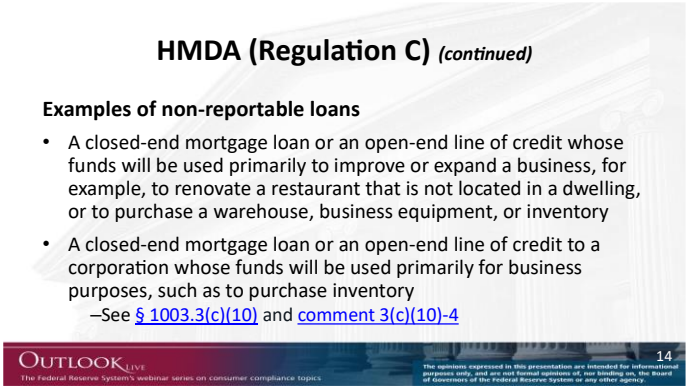
The second example is a loan to a corporation, if the funds from the loan or line of credit will be used to purchase or to improve a dwelling, or if the transaction is a refinancing.

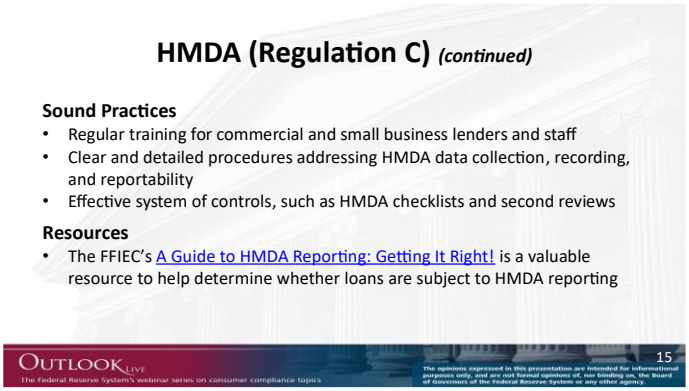


The following are examples of transactions that are not covered loans because they primarily are for a business or commercial purpose, but they do not meet the definition of a home improvement loan, a home purchase loan, or a refinancing under the requirements for them to be reportable.

So here we have a closed-end mortgage loan or an open-end line of credit whose funds will be used primarily to improve or expand a business, for example, to renovate a family restaurant that is not located in a dwelling, or to purchase a warehouse, business equipment, or inventory.

We also have a closed-end mortgage loan or an open-end line of credit to a corporation whose funds will be used primarily for business purpose, such as to purchase inventory.

These are examples of a closed-end mortgage loan or an open-end line of credit whose funds will be used primarily for business or commercial purposes other than home purchase, home improvement, or refinancing, even if the loan or line of credit is cross collateralized by a covered loan.



Some sound practices banks can employ to reduce the risk of noncompliance:

- The first is ensuring that HMDA reporters appropriately capture dwelling-secured credit that may have been originated primarily for business or commercial purposes but are home improvement loans, home purchase loans, or refinancings. It is important that commercial

lending management is aware of the transactional reporting requirements applicable to their area, with appropriate coordination with the individual or individuals responsible for maintaining the bank's HMDA-reporting process.

- You should also ensure regular training for staff in other divisions that would not immediately consider HMDA reporting requirements, such as commercial and small business lenders and staff.
- You should also ensure you have clear procedures and effective controls, such as checklists and second reviews, and dedicated personnel that would be able to effectively identify errors in reporting requirements prior to submission.

As noted earlier, the FFIEC's A Guide to HMDA Reporting: Getting It Right! is a valuable resource to help determine whether loans are subject to HMDA reporting.

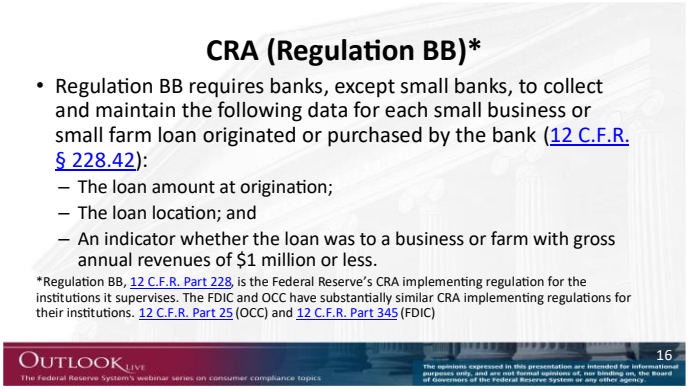
As a quick recap for appropriate reporting:

- Determine if the loan is a closed-end mortgage loan or open-end line of credit. Remember, closed-end mortgage loans and open-end lines of credit must, by definition, be secured by a dwelling.
- Determine if any other exclusions apply, including whether the loan is primarily for business or commercial purposes. If an exclusion applies, it is not reportable.
- However, the exclusion does not apply if the business or commercial purpose loan meets the definition of home improvement, home purchase, or refinance. If the loan meets any of those definitions, it is reportable. If not, then it is not a reportable loan.

With that, I will hand it over to Kevin to continue with the rest of our presentation. Thank you.

Kevin O'Connor – Federal Reserve Bank of Boston:

Thank you, Beatriz.



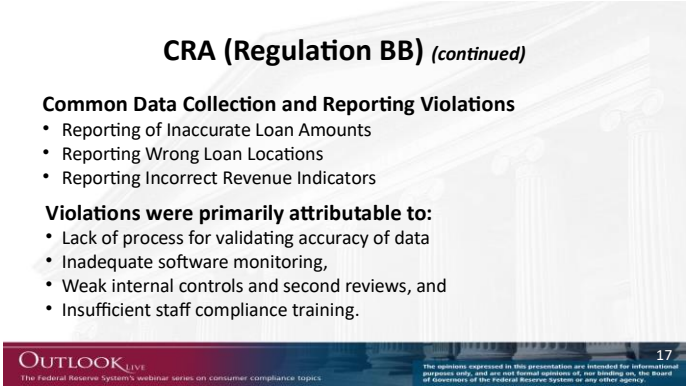
We'll jump into CRA with a brief foundation here. The CRA and Regulation BB require regulators to evaluate the extent to which banks are meeting the credit needs of their communities.

Banks are divided into three primary categories: large, small, and intermediate small (or ISB), and that's based on their asset size. The asset-size threshold for large banks is $1.609 billion as of 2025,[3] and that's important because being a large bank comes with data reporting requirements, which are detailed in Regulation BB (12 C.F.R. §228.42).

As Beatriz noted earlier, I will note here that the regulation includes numerous reporting requirements for large banks, but for the purposes of this webinar, we are focusing on the requirement for large banks to collect, maintain, and report certain small business and small farm loan data.

What exactly is a small business loan or a small farm loan? The collection of data for small business loans is limited to loans whose original amounts are $1 million or less and are reported on the Call Report (Part I) as either "loans secured by nonfarm or nonresidential real estate" or "commercial and industrial loans." A small farm loan must be reported if the original amount was for $500,000 or less, and if it was reported on the Call Report under either "loans to finance agricultural production and other loans to farmers" or "loans secured by farmland." For each small business or small farm loan originated or purchased, large banks must collect, maintain, and/or report certain data, which include among other things:

- The loan amount at origination;
- The loan location; and
- An indicator whether the loan was to a business or farm with gross annual revenues of $1 million or less.



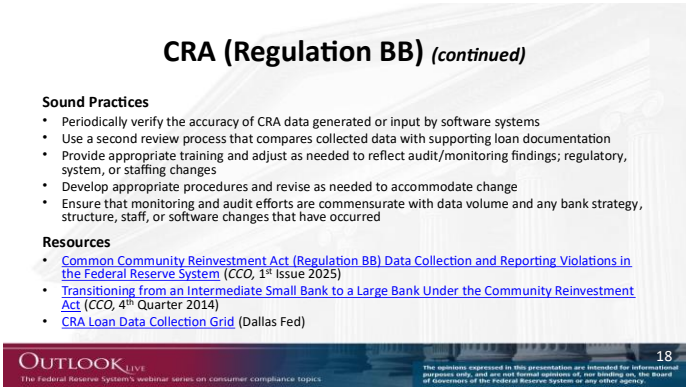
Federal Reserve examiners see violations related to the accuracy of these data points in particular.

- First, examiners found errors in Loan Amounts, caused by the bank's software pulling information from the wrong core system data fields and inadvertent manual input errors by bank personnel. The errors were primarily attributed to the lack of a process to periodically validate the accuracy of data by bank software systems and to weak bank controls and secondary review processes that did not verify collected data against source documents.

[3] The current and historical CRA asset-size thresholds are available at: https://www.ffiec.gov/data/cra/reporting-criteria.

- Second, examiners identified errors in Loan Locations. These errors were due to bank staff reporting census tract data based on the residential address of the business or farm owner. Instead, banks are expected to document the census tract where the main business or farm is located or where the loan proceeds otherwise will be applied. In other cases, again, errors were caused by bank software improperly geocoding addresses or bank personnel inadvertently entering location information inaccurately. The root causes of the violations included insufficient staff training on data collection requirements, inadequate controls and secondary review processes, and the lack of a process to periodically verify the accuracy of geocodes generated by software systems.
- Finally, examiners have found errors in reported Revenue Indicators. These errors included failing to document code "1" when business or farm revenues were less than or equal to $1 million, code "2" when gross annual revenues were greater than $1 million, or "NA" when the bank did not collect gross annual revenue information from the business or farm. Examiners determined that the root causes of these violations were inadequate staff training and bank staff's failure to compare collected data against supporting loan documentation during second reviews.

In summary, most of the top-cited Regulation BB data collection violations occurred because of inadequate software monitoring, lack of or weaknesses in internal controls and second reviews, and insufficient staff compliance training. Additionally, examiners attributed root causes more broadly to inadequate change management oversight with boards of directors not ensuring that banks reviewed and updated their compliance management systems to align with regulatory and filing requirements, as well as to changes in bank strategy, structure, staff, or software. Regulatory change management could be particularly relevant for banks making the move from a small bank to a large bank, where reporting requirements apply.



Some sound practices that banks can employ to reduce the risk of noncompliance include:

- Periodically verifying the accuracy of CRA data generated by software systems or that is manually input by staff,
- Using a second review process that compares collected data with supporting loan documentation,

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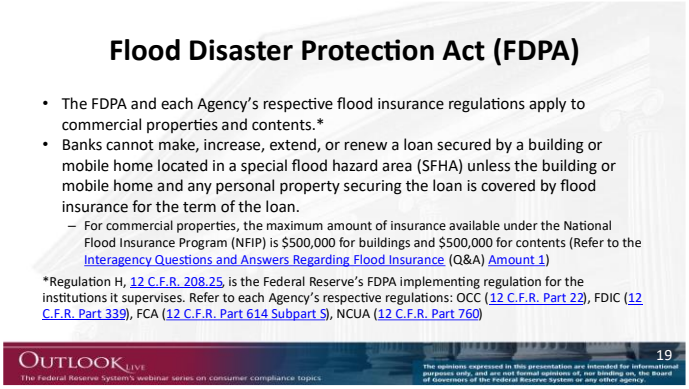
- Providing appropriate training and adjusting as needed to reflect audit or monitoring findings and regulatory, system, or staffing changes,
- Developing appropriate procedures and revising them as needed to accommodate change,
- And finally, ensuring that monitoring and audit efforts are commensurate with data volume and any changes to bank strategy, structure, staff, or software

For a great list of sound practices to mitigate compliance issues and considerations for transition from a small bank to a large bank, you can also refer to the *Consumer Compliance Outlook* articles linked on the slide.



Before we jump into the flood portion of the webinar, I want to put in a plug for another Outlook Live webinar we'll be hosting in November of this year, which will provide a detailed discussion and examiner insights into the flood insurance regulations and common violations. Please keep an eye out for the announcement and registration information that should be coming in October.

For our purposes today, we are focusing on the flood insurance requirements for commercial properties, with an emphasis on areas where we most often see violations.

The Flood Disaster Protection Act of 1973 (FDPA) mandates, with very limited exemptions, that lenders cannot make, increase, extend, or renew a loan secured by a building or mobile home in a special flood hazard area unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan.

The amount of insurance must be at least equal to the lesser of the outstanding principal balance of the loan or the maximum limit of coverage available for the particular type of property under the Act through the National Flood Insurance Program (NFIP). For commercial properties, the maximum coverage available is $500,000 for the building and $500,000 for its contents. It's important to note also that insurance coverage cannot exceed the insurable value of the property, which we'll dive into a little bit in a moment.

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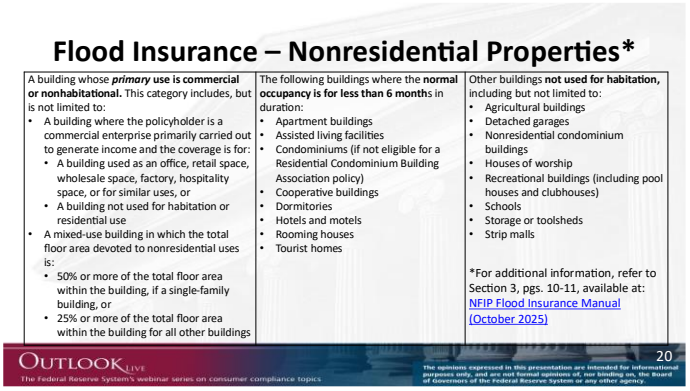
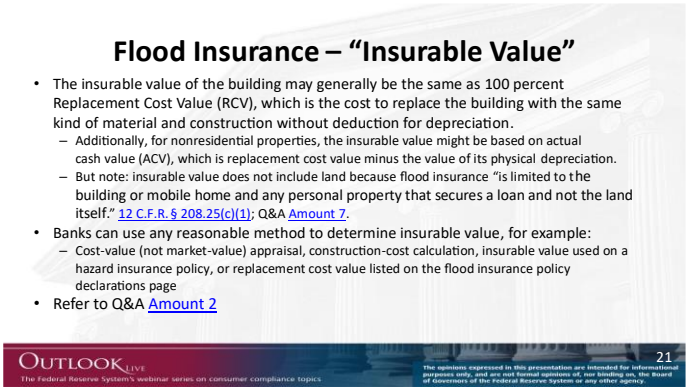


Distinguishing between commercial and residential properties is important because the amount of insurance coverage required differs based on collateral. This slide provides some examples of commercial or nonresidential buildings. First, there are the traditional commercial properties, such as factories and office buildings. There are also mixed-use properties that have space devoted to both residential and nonresidential uses. We are going to talk more about these properties in a moment. Next, there are some residential buildings that are considered commercial if the normal occupancy is less than 6 months. For example, assisted living facilities, dorms, and hotels. Finally, there are other buildings that are non-habitational, such as tool sheds and garages, schools, and agricultural buildings. With that understanding, let's talk about insurable value.



Once a property has been properly classified as residential or commercial, the bank must determine the proper amount of flood insurance coverage. The required amount is the lesser of:

- the outstanding principal balance of the loan(s), or
- the maximum amount of insurance available under the NFIP.

Now this maximum available amount actually has two tests:

- It's the lesser of the maximum amount available for the type of structure, which again, is $500,000 for commercial properties or the insurable value of the property - remember that properties cannot be insured for more than their insurable value

Insurable value is defined as the overall value of the property securing the loan minus the value of the land on which the property is located. Flood insurance does not cover land. It is important to calculate the correct insurable value of the property; otherwise, the lender might inadvertently require the borrower to purchase too much or too little flood insurance.

The insurable value of a building is generally going to be 100 percent of its replacement cost value or RCV, which is the cost to replace the building with the same kind of material and construction without deducting depreciation. However, for commercial properties, the RCV may not always be practical in determining insurable value. Instead, the insurable value might be based on actual cash value or ACV, which is RCV minus the value of physical depreciation.

In calculating the amount of insurance to require, the lender and borrower may use various ways to establish the insurable value, including:

- an appraisal based on a cost-value but not market-value,
- a construction-cost calculation,
- the insurable value from a hazard insurance policy – recognizing here that adjustments may be necessary as this value does not include the value of the foundation, or
- any other reasonable approach, as long as it can be supported.

It's not uncommon for commercial loans to be secured by business assets located in the commercial building that's located in a flood hazard area. When a loan is secured by a building and its contents, flood insurance coverage is required for both the building *and* the contents. As noted previously, the maximum amount of coverage available through the NFIP for nonresidential contents is $500,000.

The Interagency Flood Q&As clarify that the lender cannot exempt the contents from required coverage because the lender took a security interest inadvertently or out of an abundance of caution.

Also, when a security interest does exist, flood insurance is required regardless of whether the security interest is perfected under applicable law.

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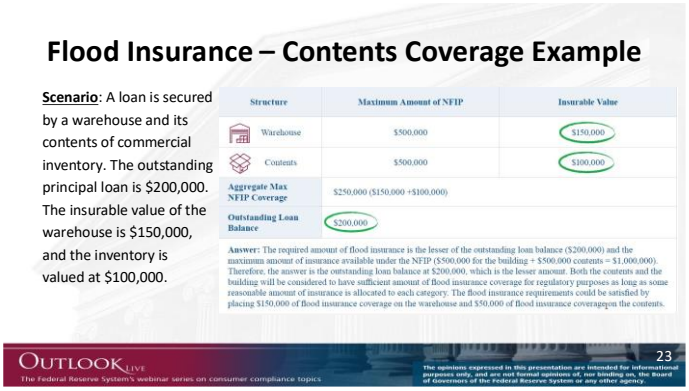
Examiners have seen situations where banks unknowingly created a security interest in commercial contents when language was added to the loan agreement to include certain business assets as collateral. Because the lender did not intend to take the contents as collateral, and was unaware of the security interest, the bank did not follow its flood procedures and exposed itself to the risk of noncompliance. Therefore, it is important that lenders control and review security instruments to ensure that any collateral securing the loan is known and intentional.

Now let's walk through an example.



Here we have a $200,000 loan secured by a warehouse and inventory.

- The insurable value of the warehouse is $150,000 and the insurable value of the inventory is $100,000.
- The maximum insurance under the NFIP is $1,000,000, which includes $500,000 for the building and $500,000 for the contents.
- However, we see that insurable value is far less than that. Therefore, the actual amount available for this transaction is $250,000, which is the sum of the $150,000 building and the $100,000 of contents.

With a $200,000 loan, however, the minimum amount of insurance required is $200,000, which the bank can allocate in any reasonable way to both the contents and the building.

I will note here also that the regulation requires at least $200,000 of coverage because the loan amount is less than the maximum amount available. In this case, the bank could require or the borrower could choose to obtain $250,000 of insurance, with $150,000 allocated to the building and $100,000 to the contents.

Now let's move into our two final flood insurance topics – multiple buildings and mixed-use buildings.

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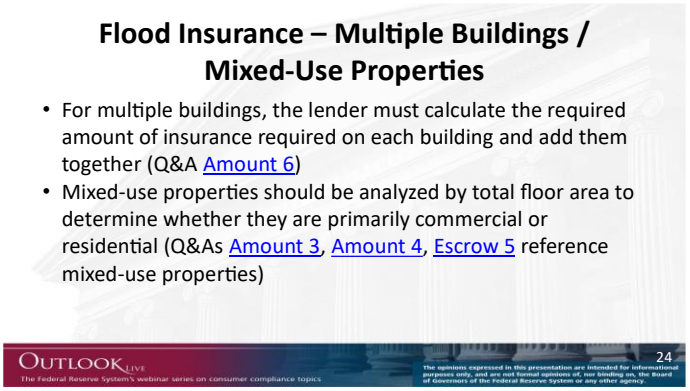
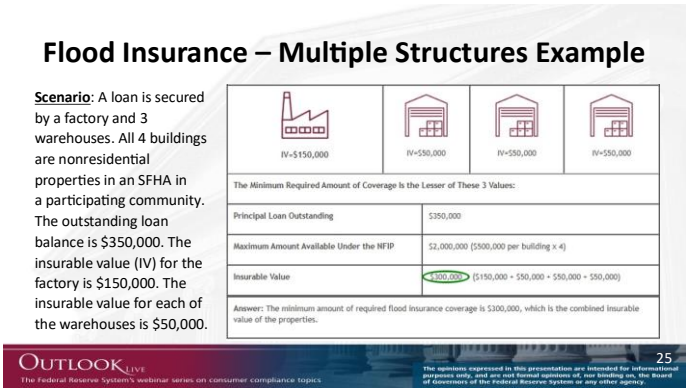


For multiple buildings, the lender must calculate the required amount of insurance required on each building and add them together. All buildings in the special flood hazard area must be covered, though the amount of total required flood insurance can be allocated among the secured buildings in varying amounts.

Mixed-use properties should be analyzed by total floor area to determine whether they are primarily commercial or residential.

For a single-family building, if 50% or more of the floor area is for commercial use, it is a commercial building for flood insurance purposes. For all other buildings, if 25% or more of the floor area is for commercial use, it is a commercial building.

Now let's walk through some examples to clarify these points.



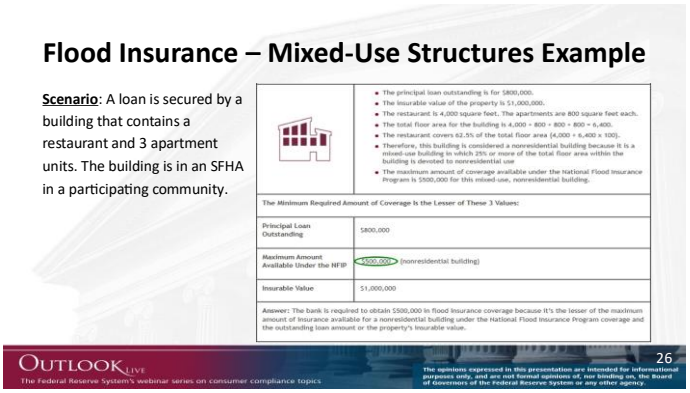
Here we have a loan secured by a factory and three warehouses. All four buildings are non-residential.

- The outstanding loan balance is $350,000.
- The insurable value for the factory is $150,000 and the insurable value for each of the warehouses is $50,000. This aggregates to a total insurable value of $300,000 for all of the buildings.
-

- The minimum amount of coverage in this scenario is equal to the insurable value of the property of $300,000.

Now I'll note here too that the minimum requirement is also the maximum available. Even though the loan amount exceeds the insurable value, flood insurance is limited on the upside by the buildings' insurable value.

Now let's try a mixed-use example.



Here we have a loan that is secured by a building that contains a restaurant and three apartment units, so it is part commercial and part residential.

- The principal loan outstanding is $800,000.
- The insurable value of the property is $1,000,000.

We need to figure out whether this is primarily a residential or commercial property using a floor area calculation.

- The restaurant is 4,000 square feet and the apartments are 800 square feet each.
- The total floor area for the building is 6,400 square feet (4,000 + 800 + 800 + 800), and the restaurant at 4,000 square feet covers 62.5% of the total floor area (4,000 ÷ 6,400 x 100). Therefore, this building is considered a nonresidential building because it is a mixed-use building in which 25% or more of the total floor area is devoted to nonresidential use.
- Therefore, the maximum amount of coverage available under the NFIP is $500,000.

However, there is nothing here preventing the borrower from getting excess coverage up to the insurable value of $1 million, which could be accomplished with a private policy to cover the full insurable value or to cover the difference between insurable value and the available NFIP coverage.

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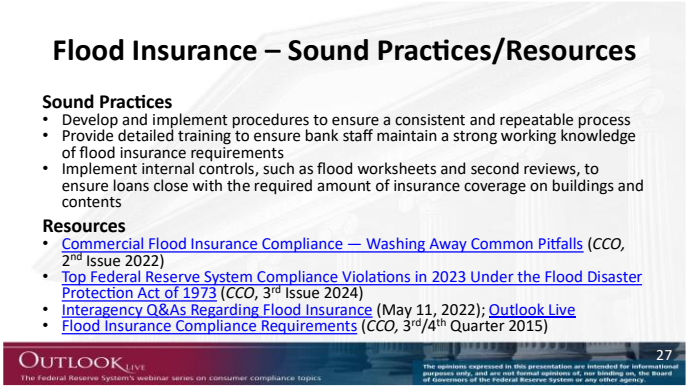


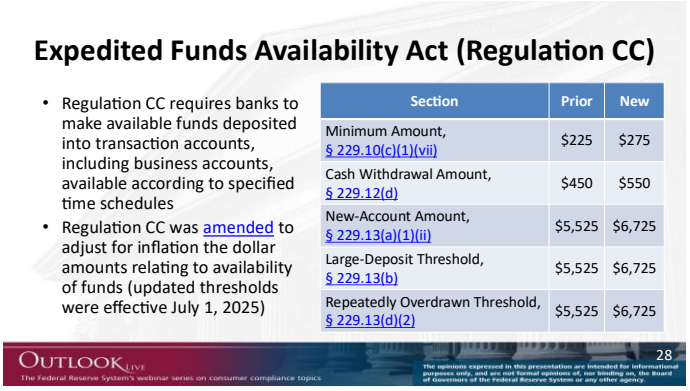
So far, we've discussed some of the regulatory requirements and issues that are common with commercial properties. Now let's walk through some sound practices banks can use to reduce the risk of noncompliance.

- First, develop and implement procedures to ensure consistent and repeatable processes for onboarding and monitoring flood loans.
- Second, provide detailed training to ensure bank staff maintain a strong working knowledge of flood insurance requirements.
- Third, implement internal controls, such as flood worksheets and second reviews, to ensure loans close with the required amount of insurance on buildings and contents.

For additional information, there are numerous *Consumer Compliance Outlook* articles about flood insurance requirements, which are very helpful and linked on this slide. Also, in May of 2022, the Interagency Q&As were updated and provide a wealth of guidance on these regulations. In July of 2022, the banking agencies hosted an Outlook Live webinar to highlight the changes in the Q&As., and that webinar is also linked on this slide.

Again, we'll be hosting a flood insurance Outlook Live webinar later this year in November.

Now let's move on to review several other consumer protection laws and regulations that apply to commercial products and services.



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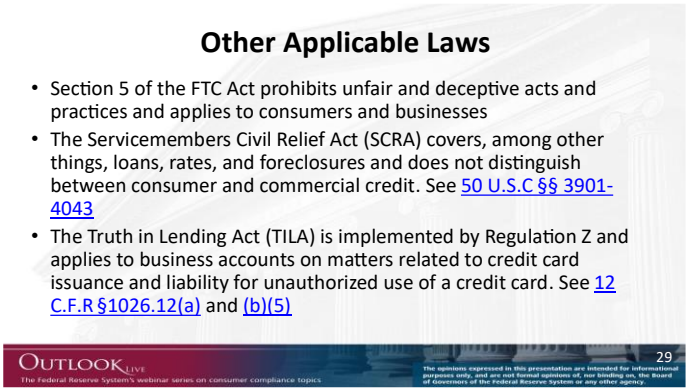
The Expedited Funds Availability Act, as implemented by Regulation CC, applies to both consumer and commercial accounts. Among other requirements, the law and regulation set forth the requirement that depository institutions make funds deposited into transaction accounts available according to specified time schedules and that they disclose their funds availability policies to their customers. Just this year, in July, availability amounts were updated in the regulation, as you can see on this slide.



Section 5 of the FTC Act generally applies to both consumers and small businesses. For example, the Federal Reserve has included small business accounts in UDAP actions related to certain overdraft program methodologies, evaluating affected customers, consumers and business alike.

Also, the Federal Reserve's *Consumer Compliance Outlook* article titled, "Compliance Spotlight: Supervisory Observations on Representment Fees" is relevant for both consumer and small business accounts.

Generally, banks should view their commercial business practices through a UDAP lens to mitigate this risk. This may include incorporating business products and services into UDAP risk assessments, including UDAP considerations and questions when developing or onboarding new commercial products, and dedicating audit and testing resources to review UDAP in commercial business lines.

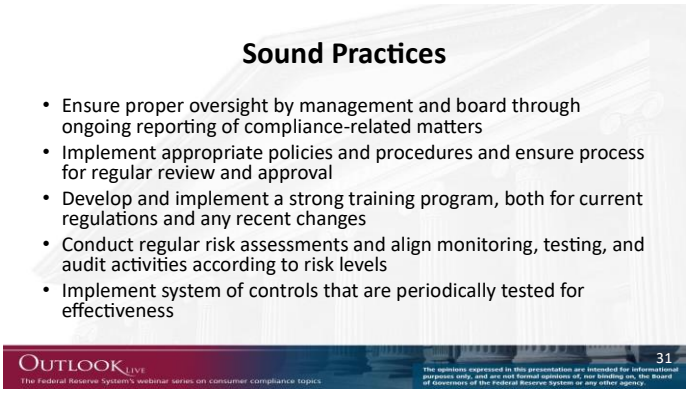
The Servicemembers Civil Relief Act (SCRA) provides certain financial protections to servicemembers and, in some cases, their spouses, dependents, and other persons subject to the obligations of servicemembers.

- The SCRA covers a broad range of issues such as rental agreements and mortgage foreclosure, eviction, installment loans, and auto leases and repossessions. It also covers certain credit terms such as credit card interest rates and mortgage interest rates.
- SCRA protections apply to obligations contracted prior to entering military service and apply to servicemembers and joint obligations of servicemembers and their spouses.
- Importantly, the SCRA does not distinguish between consumer and commercial credit, and therefore, banks should maintain procedures and controls and provide appropriate training to mitigate the risk of noncompliance with the Act.

And finally, the Truth in Lending Act (TILA), as implemented by Regulation Z, seeks to provide "meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." While TILA and Regulation Z is almost exclusively a consumer regulation, two provisions may apply to credit cards issued for business purposes.

- First, credit cards can be issued, regardless of their purpose, only in response to an application, or oral or written request, or as a substitute for or renewal of an existing card.
- Additionally, the cardholder liability provisions apply to any person, including organizations, to whom a credit card is issued for any purpose, even business. See Comment 12(b)—1. It is important to note here that if 10 or more credit cards are issued by one card issuer for use by the employees of an organization, Reg. Z does not prohibit the card issuer and the organization from agreeing to liability for unauthorized use without regard to the regulation. However, liability for unauthorized use may be imposed on an employee of the organization, by either the card issuer or the organization, only in accordance with Regulation Z.

The Federal Reserve's *Consumer Compliance Outlook* publication and Outlook Live webinar series has developed numerous helpful resources to help banks and other financial services organizations and professionals comply with these laws and regulations. Some of these resources are linked here on this slide.



In this webinar, we provided insights into the consumer protection laws and regulations applicable to commercial products and services and offered sound practices to mitigate the risk of

noncompliance. Those sound practices all tie back to the essential pillars of an effective compliance management system: board and management oversight; policies and procedures, including training; risk monitoring and management information systems; and internal controls.

In summary, banks should consider the following sound practices to mitigate compliance risk for commercial products and services:

- First, ensure proper oversight by management and the board through ongoing reporting of compliance-related matters. This can help ensure that appropriate action is taken when issues arise and that resources are dedicated to address identified risks and violations.
- Second, implement appropriate policies and procedures and ensure regular review and approval of those policies and procedures. This helps ensure that management and staff have a uniform understanding of expectations, responsibilities, and requirements for carrying out their job function, in alignment with applicable laws and regulations.
- Third, develop and implement a strong training program, both for current regulations and any recent changes. This helps ensure that staff and management, and the board, have a clear understanding of the law so as to better carry out their job duties and align bank policies, procedures, and practices with legal and regulatory requirements.
- Fourth, conduct regular risk assessments and align monitoring, testing, and audit activities according to risk levels. This helps ensure management teams are aware of the risks facing their banks and the controls designed to manage them. It also helps ensure that the resources dedicated to monitor risks bear a consistent and understandable relationship to the risk level.
- And finally, implement a system of internal controls that is periodically tested for effectiveness. Embedded first-line controls should be reasonably designed to prevent and detect issues, while second- and third-line testing can help ensure that first-line controls are working as designed and are effective at managing compliance risk.

At this time, I'll turn it back to Jean to take us into the Q&A portion of the webinar.

Jean Roark – Facilitator:

Thanks so much Kevin. I appreciate it. We do have a couple of questions regarding spousal signatures. The first question – what is the best way to document when spouses are taken as guarantors when the spouse has no ownership in the business? That's question one, and the second, can a joint intent document show the borrower was given the option of any guarantor, but the spouse chose to be involved?

Beatriz Martinez – Federal Reserve Bank of Chicago:

I'll address question one first. In a typical fashion, it depends. If a spouse, who has no ownership interest, wants to be a guarantor to the transaction, the creditor should document that intent similar to how it would document joint intent to apply for credit, which, according to Regulation B, must be done at the time of application.

Some banks use forms for commercial loans similar to the model application forms in Appendix B to Regulation B, but we do often see the language expanded to include the intent to apply for joint credit or to act as joint guarantors.

If, however, an additional party is necessary to support the credit requested, Regulation B indicates that a creditor may request a cosigner, guarantor, endorser or similar party, and the applicant's spouse may serve as an additional party, but the creditor shall not require that the spouse be the additional party. You typically see this in a counter-offer situation, where a creditor issues an adverse action notice that communicates that the applicant does not have sufficient strength for approval without a co-applicant, guarantor, or the pledge of additional collateral, and allows the applicant to suggest how it will strengthen the credit. So, a creditor could use a form similar to the model form C-4 to offer the customer a counteroffer.

As reference, the article we included as a resource on slide 11, it's titled, "Regulation B and Marital Status Discrimination: Are you in Compliance?" is a valuable resource that highlights the spousal signature provisions and some sound practices for "getting it right."

To address the second question, I'll repeat it real quick. Can a joint intent document show the borrower was given the option of any guarantor, but the spouse chose to be involved, rather than a whole different document?

If the situation involves a credit where an additional party is necessary to support the credit requested, Regulation B indicates that a creditor may request a cosigner, guarantor, endorser or similar party, and the applicant's spouse may serve as an additional party, but the creditor shall not require that the spouse be the additional party. I think I already answered that second question within the response to the first question. Again, it's in these counteroffers that we typically see when a bank utilizes that form, C-4, in Appendix C to Regulation B, when they issue the adverse action notice that communicates why the applicant does not have sufficient strength for approval

without these additional parties. We just want to make sure the counteroffer does not specify who is expected to fulfill these roles. It's important in these situations to allow the borrower to dictate how it wants to address the need to strengthen the credit.

Jean Roark – Facilitator:

Thank you, Beatriz.

The next question relates to flood insurance. We have situations where the loan file does not contain a Special Flood Hazard Determination Form, and instead, the loan conversation notes indicate "vacant land" or "unimproved" as support for why a flood determination was not obtained. These files also don't generally include any supporting documentation to evidence that there are no structures. Should we institute an internal procedure to obtain a flood determination on any real estate secured loan, since the SFHDF arial map will support no structures are on the collateral?

Kevin O'Connor – Federal Reserve Bank of Boston:

Jean, thanks for the question.

This sounds like a question of procedure and documentation. First, banks are required to use the Special Flood Hazard Determination Form when determining whether a building or mobile home offered as collateral security for a loan is or will be located in a special flood hazard area. If the loan is secured by vacant land, the use of a Standard Flood Hazard Determination Form is not required. The regulations, however, don't specify any review or documentation is required to evidence whether the land contains any insurable structures. That being said, from a risk management perspective, a sound practice might be to maintain those procedures. For example, documenting review or appraisals of real estate collateral to ensure the land is vacant and unimproved. Remember, lenders are not exempt from the flood insurance regulations simply because they were unaware of a security interest that they created or if the security interest was taken inadvertently.

I'll just quickly note too that construction loans are a little bit different. In the case of construction loans, a lender will pull a Standard Flood Hazard Determination Form to determine whether a building to be constructed, that will be security for the loan, is or will be located in an Special Flood Hazard Area. These are actually included in the flood Q&As – Construction 1-6, which are specific to construction loans.

Jean Roark – Facilitator:

The next question – How do examiners evaluate proper documentation for compliance with Regulation B and HMDA when it comes to commercial loans considering that many systems are designed with consumer lending in mind?

Beatriz Martinez – Federal Reserve Bank of Chicago:

For Regulation B requirements, we touched on those best practices a bit during the presentation. But what we look for are internal controls such as checklists that evidence how you take these requirements into consideration during the loan process. For example, the adverse action notice requirements for commercial loans are dependent on different factors than consumer loans, so creating a checklist specific for this purpose and integrating those different factors, such as gross revenue – we know that there is a difference [in adverse action notification requirements] between less than a million or more than a million in gross revenues – that supports how the bank is complying with requirements. For HMDA, having clear identification of the property type and the loan purpose within the file that supports whether or not it is a reportable loan confirms to us your understanding of the requirement and further supported by the loan being reported on the HMDA LAR or not.

Jean Roark – Facilitator:

Thank you so much, Beatriz.

We are about at time, so we are going to go ahead and close out our event, but we definitely appreciate all the questions that we received. When we do officially close out, Zoom will send you to our survey page, so please take a moment to share your comments and suggestions. We do read every single response and strive to make our sessions better based on your feedback. We will also send an email out tomorrow with the survey link, but you only need to fill it out once. We definitely appreciate your responses.

I'd like to thank our presenters today, Beatriz Martinez and Kevin O'Connor, and our Outlook Live team for sharing their time and expertise. As a quick reminder, be sure to check our website, www.consumercomplianceoutlook.org. In a few days, there, you should find the archive of this call and information on upcoming sessions.

Thanks for joining us today. This concludes today's Outlook Live webinar. Enjoy the rest of your day.

[Event Concluded]