

# Consumer Compliance Handbook

**Division of Consumer and Community Affairs**



Inquiries or comments relating to the contents of this manual should be addressed to:

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# About this Handbook

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Since the late 1960s, Congress has enacted a number of consumer protection and civil rights laws directly related to the activities of financial institutions. Most transactions involving consumers and financial institutions are covered by these laws. The Board of Governors is responsible for administering and enforcing the laws for state-chartered banks that are members of the Federal Reserve System (state member banks)—and, with respect to some of the laws, for foreign banking organizations. Oversight of this area is assigned to the Board's Division of Consumer and Community Affairs; direct supervision of individual institutions to determine their compliance with the laws, and the implementing regulations, is largely the responsibility of the Federal Reserve Banks, operating under delegated authority. Specially trained consumer compliance examination staff help carry out the Board's consumer compliance supervision program.

## Intended Use

This *Consumer Compliance Handbook* provides Federal Reserve examiners (and other System compliance personnel) with background on the consumer compliance regulations and statutes covered by the Board's consumer compliance supervision program and guidelines for conducting consumer compliance examinations. Others in the compliance profession may also find it useful.

The *Handbook* describes each regulation (or, if no regulation exists, the statute) and, for most of the regulations, provides examination objectives, examination procedures, and a detailed examination checklist. Although most of the regulations are discussed in some detail, the discussions are not intended as a substitute for the regulation (or the statute). For complete information, examiners should refer to the regulation itself, as well as the statute, official interpretations, and any related CA Letters issued by the Division of Consumer and Community Affairs.

The *Handbook* primarily concerns examinations of state member banks, but it also covers supervisory activities related to foreign banking offices. For simplicity, most discussions refer to "state member banks" (or just "banks"), even when they may apply to foreign banking offices. In addition, the material on risk-focused consumer compliance supervision, which is currently being revised, applies in part to the supervision of LCBOs (large

complex banking organizations), including those without a state member bank.<sup>1</sup>

## Contents

The first part of the *Handbook* covers aspects of the examination process in general; the remaining parts focus on individual regulations (or, in some cases, individual statutes):

- I. Risk-focused consumer compliance supervision
- II. Deposit-related regulations and statutes
- III. Credit-related regulations and statutes
- IV. Other regulations, rules, policies, and statutes
- V. Federal fair lending regulations and statutes
- VI. Community Reinvestment Act

## Relationship to FFIEC-Issued Material

The *Handbook* has been prepared specifically for Federal Reserve examiners. Some of the chapters concerning regulations or statutes for which the FFIEC has issued supervisory materials are adapted from FFIEC documents. The differences between the *Handbook* and FFIEC materials are not substantive and primarily involve formatting or other minor changes to increase consistency among individual *Handbook* chapters.

## Updates

Informal updates will be provided to System staff through CA Letters, conference calls, and other means of internal communication, as circumstances dictate. Formal updates will be distributed at least annually.

## Questions

Questions and comments about this *Handbook* should be directed to the Manager, Reserve Bank Oversight, Division of Consumer and Community Affairs.

An electronic version of this printed handbook is available on the Board's web site, at <http://www.federalreserve.gov/boarddocs/SupManual/default.htm>.

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1. The material on risk-focused consumer compliance supervision is not included in this edition of the *Handbook*.



# Consumer Compliance Handbook

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# Risk-Focused Consumer Compliance Supervision Framework

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## Overview of the Program

The Board adopted a program for risk-focused consumer compliance supervision in 1997. Since then, the program has been modified several times to increase its efficiency and effectiveness in an evolving banking environment. The procedures implementing the risk-focused consumer compliance supervision program are currently being revised to, among other things, incorporate a wide range of existing supervisory guidance.<sup>1</sup> Once the revised procedures have been tested and formally approved, they will be added to this *Consumer Compliance Handbook*.

The risk-focused consumer compliance supervision program is designed to reasonably ensure that all organizations supervised by the Federal Reserve comply with consumer protection laws and regulations. It is founded on the expectation that consumer compliance risk management is an integral part of the corporate-wide risk management function of each state member bank and bank holding company.

The risk-focused supervision program directs System resources to organizations, and to the activities within those organizations, commensurate with the level of risk to both the organization and consumers. This focusing of resources reduces burden on those organizations that already have appropriate risk mitigators in place. In recognition of the rapidity of change in the financial services industry, the program is designed to be adaptable to different types of organizations and risk profiles.

Particularly in a period of rapid change, the more informed organizations are about the regulatory environment in which they operate, the greater the opportunity for them to achieve compliance on their own. For that reason, the program supplements traditional supervisory activities with timely communications concerning consumer compliance regulatory and supervisory matters. Given the interrelationship among different types of risk, the program

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1. The procedures are also being revised to incorporate revised guidance related in part to the supervision of LCBOs (large complex banking organizations), including those without a state member bank.

requires examination reports and other products of the supervision process to be meaningful to all stakeholders, including the supervised entities, the Federal Reserve, and state banking authorities.

Following are some highlights of the program:

- Provides for the efficient and effective deployment of System resources by allowing Reserve Banks to tailor supervisory activities to the size, structure, complexity, and risk of the bank. As a result, both the frequency and depth of review should be commensurate with a bank's risk profile. Sufficient information about the use of resources will be captured and analyzed to help direct future decision making at the System and Reserve Bank levels.
- Incorporates guidelines for evaluating compliance management programs in the context of risk to the organization as well as to consumers. These guidelines will be evaluated routinely and updated as necessary to reflect changing risk within the financial services industry. The program will provide specific guidance on evaluating the efficacy of internal controls and audit programs as well as on applying appropriate testing methodologies.
- Requires coordination with other supervisory disciplines and other regulators, as warranted, to ensure a full understanding of the organization's risk profile such that consumer compliance risks are incorporated into overall risk assessments and consumer compliance ratings influence overall management ratings and risk management ratings as appropriate. The form of specific supervisory products will be dictated by the needs of relevant stakeholders.
- Promotes communication between supervised organizations and Reserve Banks, outside of the supervisory process, for the purpose of sharing timely information about industry developments and consumer compliance risk management practices as well as changes to laws and regulations. Resulting improvement in institutions' risk management programs should allow for more-efficient use of examiner time and resources while reducing regulatory burden.





# Regulation E

## Electronic Fund Transfers

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The Electronic Fund Transfer Act (EFTA) (15 USC 1693 et seq.) of 1978 is intended to protect individual consumers engaging in electronic fund transfers (EFTs). EFT services include transfers through automated teller machines, point-of-sale terminals, automated clearinghouse systems, telephone bill-payment plans in which periodic or recurring transfers are contemplated, and remote banking programs. The Federal Reserve Board (Board) implements EFTA through Regulation E, which includes an official staff commentary.

The Electronic Signatures in Global and National Commerce Act (the E-Sign Act), 15 USC 7001 et seq., became effective October 1, 2000, and allows electronic documents and signatures to have the same validity as paper documents and handwritten signatures. Disclosures in consumer transactions provided in electronic form would satisfy Regulation E's written disclosure requirement only if the financial institution received proper consent under the E-Sign Act. If a financial institution provides disclosures in both paper and electronic form, the paper form can be used to meet the disclosure requirements, and E-Sign consent is not required. The Board issued final rules for the electronic delivery of disclosures required under Regulation E on December 10, 2007 (72 Fed. Reg. 63,452 (Nov. 9, 2007)).

To help give clarity and a broad understanding of the requirements of Regulation E, the following background does not strictly follow the order of the regulatory text and is arranged as follows:

- I. Scope (205.2, 205.3)
- II. Disclosures (205.4, 205.7, 205.8, 205.16)
- III. Issuance of access devices (205.5, 205.18)
- IV. Consumer liability and error resolution (205.6, 205.11)
- V. Receipts and periodic statements (205.9, 205.18)
- VI. Other requirements (205.10, 205.14, 205.15)
- VII. Relation to other laws (205.12)
- VIII. Administrative enforcement and record retention (205.13)
- IX. Miscellaneous (EFTA provisions not reflected in Regulation E)

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NOTE: This chapter is adapted, with a few minor format, stylistic, and wording changes where appropriate, from the updated Interagency Examination Procedures for Regulation E distributed in August 2008 as an attachment to CA Letter 08-7.

For ease of use by the examiner, however, the examination procedures and checklist track the regulation.

### I. Scope

#### Key Definitions

*Access device* is a card, code, or other means of access to a consumer's account or a combination used by the consumer to initiate EFTs. Access devices include debit cards, personal identification numbers (PINs), telephone transfer and telephone bill payment codes, and other means to initiate an EFT to or from a consumer account. (Section 205.2(a)(1) and Staff Commentary 205.2(a)-1).

Access devices do not include

- Magnetic tape or other devices used internally by a financial institution to initiate electronic transfers,
- A check or draft used to capture the MICR (Magnetic Ink Character Recognition) encoding or routing, account, and serial numbers to initiate a one-time ACH debit. (Staff Commentary 205.2(a)-1 and -2).

*Accepted access device* is a device that a consumer

- Requests and receives, or signs, or uses (or authorizes another to use) in order to transfer money between accounts or to obtain money, property, or services;
- Requests validation of, even if it was issued on an unsolicited basis; or
- Receives as a renewal or substitute for an accepted access device from either the financial institution that initially issued the device or a successor. (Section 205.2(a)(2)).

*Account* includes a

- Checking, savings, or other consumer asset account held by a financial institution (directly or indirectly), including certain club accounts, established primarily for personal, family, or household purposes; or
- "*Payroll card account*," established through an employer (directly or indirectly), to which EFTs of the consumer's wages, salary, or other employee compensation (such as commissions) are made on a recurring basis. The payroll card account can be operated or managed by the employer, a third-party processor, a depository institution, or any other person. All transactions involving the

transfer of funds to or from a payroll card account are covered by the regulation. (Section 205.2(b)(1) and Staff Commentary 205.2(b)-1).

An account does not include an account held by a financial institution under a bona fide trust agreement; an occasional or incidental credit balance in a credit plan; profit-sharing and pension accounts established under a bona fide trust agreement; escrow accounts such as for payments of real estate taxes, insurance premiums, or completion of repairs; or accounts for purchasing U.S. savings bonds. (Section 205.2(b)(3) and Staff Commentary 205.2(b)-3).

A “payroll card account” does not include a card used

- Solely to disburse incentive-based payments (other than commissions that represent the primary means through which a consumer is paid) that are unlikely to be a consumer’s primary source of salary or other compensation.
- Solely to make disbursements unrelated to compensation, such as petty cash reimbursements or travel per diem payments.
- In isolated instances such as when an employer does not make recurring payments. (Staff Commentary 205.2(b)-2).

*ATM operator* is any person that operates an ATM at which a consumer initiates an EFT or a balance inquiry and that does not hold the account to or from which the transfer is made or about which the inquiry is made. (Section 205.16(a)).

*Electronic funds transfer (EFT)* is a transfer of funds initiated through an electronic terminal, telephone, computer (including on-line banking), or magnetic tape for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit a consumer’s account. EFTs include, but are not limited to, point-of-sale (POS) transfers; automated teller machine (ATM) transfers; direct deposits or withdrawals of funds; transfers initiated by telephone; and transfers resulting from debit card transactions, whether or not initiated through an electronic terminal. (Section 205.3(b)).

*Electronic terminal* is an electronic device, other than a telephone call by a consumer, through which a consumer may initiate an EFT. The term includes, but is not limited to, point-of-sale terminals, automated teller machines, and cash-dispensing machines. (Section 205.2(h)).

*Preauthorized electronic fund transfer* is an EFT authorized in advance to recur at substantially regular intervals. (Section 205.2(k)).

*Unauthorized electronic fund transfer* is an EFT from a consumer’s account initiated by a person other than the consumer without authority to initiate

the transfer and from which the consumer receives no benefit. This does not include an EFT initiated

- By a person who was furnished the access device to the consumer’s account by the consumer, unless the consumer has notified the financial institution that transfers by that person are no longer authorized;
- With fraudulent intent by the consumer or any person acting in concert with the consumer; or
- By the financial institution or its employee. (Section 205.2(m)).

### Coverage—Section 205.3

The requirements of Regulation E apply only to accounts for which there is an agreement for EFT services to or from the account between (i) the consumer and the financial institution or (ii) the consumer and a third party, when the account-holding financial institution has received notice of the agreement and the fund transfers have begun. (Staff Commentary 205.3(a)-1).

Regulation E applies to all persons, including offices of foreign financial institutions in the United States, that offer EFT services to residents of any state, and it covers any account located in the United States through which EFTs are offered to a resident of a state, no matter where a particular transfer occurs or where the financial institution is chartered. (Staff Commentary 205.3(a)-3). Regulation E does not apply to a foreign branch of a U.S. financial institution unless the EFT services are offered in connection with an account in a state, as defined in section 205.2(l). (Staff Commentary 205.3(a)-3).

### Exclusions from Coverage

Section 205.3(c) describes transfers that are not EFTs and are therefore not covered by the EFTA and Regulation E:

- Transfers of funds originated by check, draft, or similar paper instrument.
- Check guarantee or authorization services that do not directly result in a debit or credit to a consumer’s account.
- Any transfer of funds for a consumer within a system that is used primarily to transfer funds between financial institutions or businesses, for example, Fedwire or other similar network.
- Any transfer of funds which has as its primary purpose the purchase or sale of securities or commodities regulated by the Securities and Exchange Commission (SEC) or the Commodity

Futures Trading Commission (CFTC), purchased or sold through a broker-dealer regulated by the SEC or through a futures commission merchant regulated by the CFTC, or held in book-entry form by a Federal Reserve Bank or federal agency.

- Intra-institutional automatic transfers under an agreement between a consumer and a financial institution.
- Transfers initiated by telephone between a consumer and a financial institution provided the transfer is not a function of a written plan contemplating periodic or recurring transfers. A written statement available to the public, such as a brochure, that describes a service allowing a consumer to initiate transfers by telephone constitutes a written plan.
- Preauthorized transfers to or from accounts at financial institutions with assets of less than \$100 million on the preceding December 31. Such preauthorized transfers, however, remain subject to the compulsory use prohibition under section 913 of the EFTA and 12 CFR 205.10(e), as well as the civil and criminal liability provisions of sections 915 and 916 of the EFTA. A small financial institution that provides EFT services besides preauthorized transfers must comply with the Regulation E requirements for those *other* services. (Staff Commentary 205.3(c)(7)-1). For example, a small financial institution that offers ATM services must comply with Regulation E in regard to the issuance of debit cards, terminal receipts, periodic statements, and other requirements.

### *Electronic Check Conversion (ECK) and Collection of Returned-Item Fees*

Regulation E covers electronic check conversion (ECK) transactions. In an ECK transaction, a consumer provides a check to a payee and information from the check is used to initiate a one-time EFT from the consumer's account. Although transfers originated by checks are not covered by Regulation E, an ECK is treated as an EFT and not a payment originated by check. Payees must obtain the consumer's authorization for each ECK transaction. A consumer authorizes a one-time EFT for an ECK transaction when the consumer receives notice that the transaction will or may be processed as an EFT and goes forward with the underlying transaction.<sup>1</sup> (Sections 205.3(b)(2)(i) and (ii) and Staff Commentary 205.3(b)(2)-3).

1. For POS transactions, the notice must be posted in a prominent and conspicuous location and a copy of the notice must be provided to the consumer at the time of the transaction. (Sections 205.3(b)(2)(i) and (ii) and Staff Commentary 205.3(b)(2)-3).

Until December 31, 2009, a person using the check to initiate the EFT must include a notice that funds may be withdrawn from the consumer's account as soon as the same day payment is received, and, as applicable, that the consumer's check will not be returned by the financial institution. (Section 205.3(b)(2)(iii) and Appendix A-6).

If a payee presents again electronically a check that has been returned unpaid, the transaction is not an EFT, and Regulation E does not apply because the transaction was originated by check. (Staff Commentary 205.3(c)(1)-1).

However, Regulation E applies to a fee collected electronically from a consumer's account for a check or EFT returned unpaid. A consumer authorizes a one-time EFT from the consumer's account to pay the fee for the returned item or transfer if (1) the person collecting the fee provides notice to the consumer stating the amount of the fee and that the person may electronically collect the fee, and (2) the consumer goes forward with the underlying transaction.<sup>2</sup> (Section 205.3(b)(3)). These authorization requirements do not apply to fees imposed by the account-holding financial institution for returning the check or EFT or paying the amount of an overdraft. (Staff Commentary 205.3(b)(3)-1).

## II. Disclosures

### Disclosures Generally—Section 205.4

Required disclosures must be clear and readily understandable, in writing, and in a form the consumer may keep. The required disclosures may be provided to the consumer in electronic form, if the consumer affirmatively consents after receiving a notice that complies with the E-Sign Act. (Section 205.4(a)(1)).

Disclosures may be made in a language other than English, if the disclosures are made available in English upon the consumer's request. (Section 205.4(a)(2)).

A financial institution has the option of disclosing additional information and combining disclosures required by other laws (for example, Truth in Lending disclosures) with Regulation E disclosures. (Section 205.4(b)).

A financial institution may combine required disclosures into a single statement if a consumer holds two or more accounts at the financial institution. Thus, a single periodic statement or

2. For POS transactions, the notice must be posted in a prominent and conspicuous location and a copy of the notice must either be provided to the consumer at the time of the transaction or mailed to the consumer's address as soon as reasonably practicable after the person initiates the EFT to collect the fee. (Section 205.3(b)(3)).

error-resolution notice is sufficient for multiple accounts. In addition, it is only necessary for a financial institution to provide one set of disclosures for a joint account. (Section 205.4(c)(l) and (2)).

Two or more financial institutions that jointly provide EFT services may contract among themselves to meet the requirements that the regulation imposes on any or all of them. When making initial disclosures (see Section 205.7) and disclosures of a change in terms or an error-resolution notice (see Section 205.8), a financial institution in a shared system only needs to make disclosures that are within its knowledge and apply to its relationship with the consumer for whom it holds an account. (Section 205.4(d)).

### Initial Disclosure of Terms and Conditions—Section 205.7

Financial institutions must provide initial disclosures of the terms and conditions of EFT services before the first EFT is made or at the time the consumer contracts for an EFT service. They must give a summary of various consumer rights under the regulation, including the consumer's liability for unauthorized EFTs, the types of EFTs the consumer may make, limits on the frequency or dollar amount, fees charged by the financial institution, and the error-resolution procedures. Appendix A to Part 205 provides model clauses that financial institutions may use to provide the disclosures.

#### *Timing of Disclosures*

Financial institutions must make the required disclosures at the time a consumer contracts for an electronic fund transfer service or before the first electronic fund transfer is made involving the consumer's account. (Section 205.7(a)).

Disclosures given by a financial institution earlier than the regulation requires (for example, when the consumer opens a checking account) need not be repeated when the consumer later authorizes an electronic check conversion or agrees with a third party to initiate preauthorized transfers to or from the consumer's account, unless the terms and conditions differ from the previously disclosed term. This interpretation also applies to any notice provided about one-time EFTs from a consumer's account initiated using information from the consumer's check. On the other hand, if an agreement for EFT services to be provided by an account-holding financial institution is directly between the consumer and the account-holding financial institution, disclosures must be given in close proximity to the event requiring disclosure (for example, when the consumer contracts for a new service). (Staff Commentary 205.7(a)-1).

Where a consumer authorizes a third party to debit or credit the consumer's account, an account-holding financial institution that has not received advance notice of the transfer or transfers must provide the required disclosures as soon as reasonably possible after the first debit or credit is made, unless the financial institution has previously given the disclosures. (Staff Commentary 205.7(a)-2).

If a consumer opens a new account permitting EFTs at a financial institution, and the consumer has already received Regulation E disclosures for another account at that financial institution, the financial institution need only disclose terms and conditions that differ from those previously given. (Staff Commentary 205.7(a)-3).

If a financial institution joins an interchange or shared network system (which provides access to terminals operated by other financial institutions), disclosures are required for additional EFT services not previously available to consumers if the terms and conditions differ from those previously disclosed. (Staff Commentary 205.7(a)-4).

A financial institution may provide disclosures covering all EFT services that it offers, even if some consumers have not arranged to use all services. (Staff Commentary 205.7(a)-5).

#### *Addition of EFT Services*

A financial institution must make disclosures for any new EFT service added to a consumer's account if the terms and conditions are different from those described in the initial disclosures. ECK transactions may be a new type of transfer requiring new disclosures. (See Appendix A-2.) (Staff Commentary 205.7(c)-1).

#### *Content of Disclosures*

Section 205.7(b) requires a financial institution to provide the following disclosures as they apply:

- *Liability of consumers for unauthorized electronic fund transfers.* The financial institution must include a summary of the consumer's liability (under section 205.6, state law, or other applicable law or agreement) for unauthorized transfers. (Section 205.7(b)(1)). A financial institution does not need to provide the liability disclosures if it imposes no liability. If it later decides to impose liability, it must first provide the disclosures. (Staff Commentary 205.7(b)(1)-1). The financial institution can choose to include advice on promptly reporting unauthorized transfers or the loss or theft of the access device. (Staff Commentary 205.7(b)(1)-3).
- *Telephone number and address.* A financial

institution must provide a specific telephone number and address, on or with the disclosure statement, for reporting a lost or stolen access device or a possible unauthorized transfer. (Staff Commentary 205.7(b)(2)-2). Except for the telephone number and address for reporting a lost or stolen access device or a possible unauthorized transfer, the disclosure may insert a reference to a telephone number that is readily available to the consumer, such as “Call your branch office. The number is shown on your periodic statement.”

- *Business days.* The financial institution’s business days. (Section 205.7(b)(3)).
- *Types of transfers; limitations on frequency or dollar amount.* Limitations on the frequency and dollar amount of transfers generally must be disclosed in detail. (Section 205.7(b)(4)). If the confidentiality of certain details is essential to the security of an account or system, these details may be withheld (but the fact that limitations exist must still be disclosed).<sup>3</sup> A limitation on account activity that restricts the consumer’s ability to make EFTs must be disclosed even if the restriction also applies to transfers made by non-electronic means.<sup>4</sup> Financial institutions are not required to list preauthorized transfers among the types of transfers that a consumer can make. (Staff Commentary 205.7(b)(4)-3). Financial institutions must disclose the fact that one-time EFTs initiated using information from a consumer’s check are among the types of transfers that a consumer can make. (See Appendix A-2.) (Staff Commentary 205.7(b)(4)-4).
- *Fees.* A financial institution must disclose all fees for EFTs or for the right to make EFTs. (Section 205.7(b)(5)). Other fees (for example, minimum-balance fees, stop-payment fees, account overdrafts, or ATM inquiry fees) may, but need not, be disclosed under Regulation E (but see Regulation DD, 12 CFR 230). (Staff Commentary 205.7(b)(5)-1). A per-item fee for EFTs must be disclosed even if the same fee is imposed on non-electronic transfers. If a per-item fee is imposed only under certain conditions, such as when the transactions in the cycle exceed a certain number, those conditions must be disclosed. Itemization of the various fees may be on

the disclosure statement or on an accompanying document referenced in the statement. (Staff Commentary 205.7(b)(5)-2).

A financial institution must disclose that networks used to complete the EFT, as well as ATM operators, may charge a fee for an EFT or for balance inquiries. (Section 205.7(b)(11)).

- *Documentation.* A summary of the consumer’s right to receipts and periodic statements, as provided in section 205.9, and notices regarding preauthorized transfers, as provided in sections 205.10(a) and 205.10(d). (Section 205.7(b)(6)).
- *Stop payment.* A summary of the consumer’s right to stop payment of a preauthorized electronic fund transfer and the procedure for placing a stop-payment order, as provided in section 205.10(c). (Section 205.7(b)(7)).
- *Liability of institution.* A summary of the financial institution’s liability to the consumer under section 910 of the EFTA for failure to make or to stop certain transfers. (Section 205.7(b)(8)).
- *Confidentiality.* The circumstances under which, in the ordinary course of business, the financial institution may provide information concerning the consumer’s account to third parties. (Section 205.7(b)(9)). A financial institution must describe the circumstances under which any information relating to an account to or from which EFTs are permitted will be made available to third parties, not just information concerning those EFTs. Third parties include other subsidiaries of the same holding company. (Staff Commentary 205.7(b)(9)-1).
- *Error resolution.* The error-resolution notice must be substantially similar to Model Form A-3 in Appendix A of Part 205. A financial institution may use different wording so long as the substance of the notice remains the same, may delete inapplicable provisions (for example, the requirement for written confirmation of an oral notification), and may substitute substantive state law requirements affording greater consumer protection than Regulation E. (Staff Commentary 205.7(b)(10)-1). To take advantage of the longer time periods for resolving errors under section 205.11(c)(3) (for new accounts as defined in Regulation CC, transfers initiated outside the United States, or transfers resulting from POS debit card transactions), a financial institution must have disclosed these longer time periods. Similarly, a financial institution relying on the exception from provisional crediting in section 205.11(c)(2) for accounts relating to extensions of credit by securities brokers and dealers (Regulation T, 12 CFR 220) must disclose

3. For example, if a financial institution limits cash ATM withdrawals to \$100 per day, the financial institution may disclose that daily withdrawal limitations apply and need not disclose that the limitations may not always be in force (such as during periods when its ATMs are off-line). (Staff Commentary 205.7(b)(4)-1).

4. For example, Regulation D (12 CFR 204) restricts the number of payments to third parties that may be made from a money market deposit account; a financial institution that does not execute fund transfers in excess of those limits must disclose the restriction as a limitation on the frequency of EFTs. (Staff Commentary 205.7(b)(4)-2).

accordingly. (Staff Commentary 205.7(b)(10)-2).

### Change in Terms; Error-Resolution Notice—Section 205.8

If a financial institution contemplates a change in terms it must mail or deliver a written or electronic notice to the consumer at least 21 days before the effective date of any change in a term or condition required to be disclosed under section 205.7(b) if the change would result in any of the following:

- Increased fees or charges;
- Increased liability for the consumer;
- Fewer types of available EFTs; or
- Stricter limitations on the frequency or dollar amounts of transfers.

If an immediate change in terms or conditions is necessary to maintain or restore the security of an EFT system or account, the financial institution does not need to give prior notice. However, if the change is to be permanent, the financial institution must provide notice in writing of the change to the consumer on or with the next regularly scheduled periodic statement or within 30 days, unless disclosures would jeopardize the security of the system or account.

For accounts to or from which EFTs can be made, the financial institution must mail, deliver, or provide electronically to the consumer, at least once each calendar year, the error-resolution notice in 12 CFR 205 Appendix A—Model Form A-3. Alternatively, the financial institution may include an abbreviated error-resolution notice substantially similar to the notice set out in Appendix A (Model Form A-3) with each periodic statement. (Section 205.8(b)).

### Disclosures at Automated Teller Machines—Section 205.16

An ATM operator that charges a fee is required to post a notice that a fee will be imposed and disclose the amount of the fee. Notices must be posted both (1) in a prominent and conspicuous location on or at the machine; and (2) on the screen or on a paper notice before the consumer is committed to paying a fee. (Section 205.16(c)(1) and (2)). The fee may be imposed by the ATM operator only if (1) the consumer is provided the required notices and (2) the consumer elects to continue the transaction. (Section 205.16(e)).

The “clear and conspicuous notice” standard applies to notices posted on or at the ATM. The “clear and readily understandable standard” applies to the content of the notice. The requirement

that the notice be in a retainable format only applies to printed notices (not those on the ATM screen). (Section 205.16(c)).

These fee disclosures are not required where a network owner is not charging a fee directly to the consumer (that is, some network owners charge an interchange fee to financial institutions whose customers use the network). If the network practices change such that the network charges the consumer directly, these fee disclosure requirements would apply to the network.

### III. Issuance of Access Devices—Sections 205.5 and 205.18

In general, a financial institution may issue an access device to a consumer only if

- The consumer requested it in writing or orally;<sup>5</sup> or
- It is a renewal of, or a substitute for, an accepted access device (as defined in section 205.2(a)).

Only one renewal or substitute device may replace a previously issued device. A financial institution may provide additional devices at the time it issues the renewal or substitute access device provided the institution complies with the requirements for issuing unsolicited access devices for the additional devices. (Staff Commentaries 205.5(a)(2)-1 and 205.5(b)-5).

A financial institution may issue an unsolicited access device only if the access device is

- Not validated—that is, it cannot be used to initiate an EFT;
- Accompanied by the explanation that it is not validated and how the consumer may dispose of it if the consumer does not wish to validate it;
- Accompanied by a complete disclosure, in accordance with section 205.7, of the consumer’s rights and liabilities that will apply if the access device is validated; and
- Validated only upon oral or written request from the consumer and after a verification of the consumer’s identity by some reasonable means. (Section 205.5(b)).

The financial institution may use any reasonable means of verifying the consumer’s identity, but the consumer is not liable for any unauthorized transfers if an imposter succeeds in validating the access device. (Staff Commentary 205.5(b)-4).

5. For a joint account, a financial institution may issue an access device to each account holder for whom the requesting holder specifically requests an access device. (Staff Commentary 205.5(a)(1)-1).

### *Payroll Card Access Devices*

Consistent with section 205.5(a), a financial institution may issue a payroll card access device only in response to an oral or written request for the device or as a renewal or substitute for an accepted access device. A consumer is deemed to request an access device for a payroll account when the consumer chooses to receive salary or other compensation through a payroll card account. (Staff Commentary 205.18(a)-1).

### *EFT Added to Credit Card*

The EFTA and Regulation E apply when the capability to initiate EFTs is added to an accepted credit card (as defined under Regulation Z). The EFTA and Regulation E also apply to the issuance of an access device that permits credit extensions under a preexisting agreement between the consumer and a financial institution to extend credit only to cover overdrafts (or to maintain a specified minimum balance). The Truth in Lending Act and Regulation Z govern the addition of a credit feature to an accepted access device and, except as discussed above, the issuance of a credit card that is also an access device. For information on Regulation E's relationship to other laws, including Truth in Lending, see section 205.12.

## **IV. Consumer Liability and Error Resolution**

### **Liability of Consumers for Unauthorized Transfers—Section 205.6**

A consumer may be liable for an unauthorized EFT (defined in section 205.2(m)), depending on when the consumer notifies the financial institution and whether an access device was used to conduct the transaction. Under the EFTA, there is no bright-line time limit within which consumers must report unauthorized EFTs. (71 Fed. Reg. 1638, 1653 (Jan. 10, 2006)).

The extent of the consumer's liability is determined solely by the consumer's promptness in notifying the financial institution. (Staff Commentary 205.6(b)-3). Other factors may not be used as a basis to hold consumers liable. Regulation E expressly prohibits the following factors as the basis for imposing greater liability than is permissible under Regulation E: the consumer was negligent (for example, wrote a PIN on an ATM card); an agreement between the consumer and the financial institution provides for greater liability; or the consumer is liable for a greater amount under state law. (Staff Commentaries 205.6(b)-2 and 205.6(b)-3).

A consumer may only be held liable for an

unauthorized transaction, within the limitations set forth in section 205.6(b), if

- The financial institution has provided the following written disclosures to the consumer:
  - A summary of the consumer's liability for unauthorized EFTs;
  - The telephone number and address for reporting that an unauthorized EFT has been or may be made; and
  - The financial institution's business days.
- Any access device used to effect the EFT was an accepted access device (as defined in section 205.2(a)); and
- The financial institution has provided a means to identify the consumer to whom the access device was issued. (Section 205.6(a)).

Regulation E allows, but does not require, the financial institution to provide a separate means to identify each consumer of a multiple-user account. (Staff Commentary 205.6(a)-2).

The limitations on the amount of consumer liability for unauthorized EFTs, the time limits within which consumers must report unauthorized EFTs, and the liability for failing to adhere to those time limits are listed in the accompanying chart. The financial institution may impose *less* consumer liability than is provided by section 205.6 based on state law or the deposit agreement. (Section 205.6(b)(6)).

### *Knowledge of Loss or Theft*

The fact that a consumer has received a periodic statement reflecting an unauthorized transaction is a factor, but not conclusive evidence, in determining whether the consumer had knowledge of a loss or theft of the access device. (Staff Commentary 205.6(b)(1)-2).

### *Timing of Notice*

If a consumer's delay in notifying a financial institution was due to extenuating circumstances, such as extended travel or hospitalization, the time periods for notification specified above shall be extended to a reasonable time. (Section 205.6(b)(4); Staff Commentary 205.6(b)(4)-1).

### *Notice to the Financial Institution*

A consumer gives notice to a financial institution about unauthorized use when the consumer takes reasonable steps to provide the financial institution with the pertinent information, whether or not a particular employee actually receives the information. (Section 205.6(b)(5)(i)). Even if the consumer

## Consumer Liability for Unauthorized Transfers

Event	Timing of consumer notice to financial institution	Maximum liability
Loss or theft of access device <sup>1</sup>	Within two business days after learning of loss or theft	Lesser of \$50 <i>or</i> total amount of unauthorized transfers
Loss or theft of access device	More than two business days after learning of loss or theft up to 60 calendar days after transmittal of statement showing first unauthorized transfer made with access device.	Lesser of \$500 <i>or</i> the sum of: (a) \$50 or the total amount of unauthorized transfers occurring in the first two business days, whichever is less, <i>and</i> (b) The amount of unauthorized transfers occurring after two business days and before notice to the financial institution. <sup>2</sup>
Loss or theft of access device	More than 60 calendar days after transmittal of statement showing first unauthorized transfer made with access device.	For transfers occurring within the 60-day period, the lesser of \$500 <i>or</i> the sum of (c) Lesser of \$50 or the amount of unauthorized transfers in first two business days, <i>and</i> (d) The amount of unauthorized transfers occurring after two business days. For transfers occurring after the 60-day period, unlimited liability (until the financial institution is notified). <sup>3</sup>
Unauthorized transfer(s) not involving loss or theft of an access device	Within 60 calendar days after transmittal of the periodic statement on which the unauthorized transfer first appears.	No liability.
Unauthorized transfer(s) not involving loss or theft of an access device	More than 60 calendar days after transmittal of the periodic statement on which the unauthorized transfer first appears.	Unlimited liability for unauthorized transfers occurring 60 calendar days after the periodic statement and before notice to the financial institution.

1. Includes a personal identification number (PIN) if used without a card in a telephone transaction, for example.

2. Provided the financial institution demonstrates that these transfers would not have occurred had notice been given within the two-business-day period.

is unable to provide the account number or the card number, the notice effectively limits the consumer's liability if the consumer sufficiently identifies the account in question, for example, by giving the name on the account and the type of account. (Staff Commentary 205.6(b)(5)-3). At the consumer's option, notice may be given in person, by telephone, or in writing. (Section 205.6(b)(5)(ii)). Notice in writing is considered given at the time the consumer mails the notice or delivers the notice for transmission by any other usual means to the financial institution. Notice may also be considered

3. Provided the financial institution demonstrates that these transfers would not have occurred had notice been given within the 60-day period.

given when the financial institution becomes aware of circumstances leading to the reasonable belief that an unauthorized transfer has been or may be made. (Section 205.6(b)(5)(iii)).

### *Relation of Error Resolution to Truth in Lending*

Regulation E's liability and error-resolution provisions apply to an extension of credit that occurs under an agreement between the consumer and a financial institution to extend credit when the



consumer's account is overdrawn or to maintain a specified minimum balance in the consumer's account. (Section 205.12(a)(1)(iii)). As provided in section 205.12 and related commentary, for transactions involving access devices that also function as credit cards, the liability and error-resolution provisions of Regulation E or Regulation Z will apply depending on the nature of the transaction:

- If the unauthorized use of a combined access device–credit card solely involves an extension of credit (other than an extension of credit described under section 205.12(a)(1)(iii)) and does not involve an EFT (for example, when the card is used to draw cash advances directly from a credit line), only Regulation Z will apply.
- If the unauthorized use of a combined access device–credit card involves only an EFT (for example, debit card purchases or cash withdrawals at an ATM from a checking account), only Regulation E will apply.
- If a combined access device–credit card is stolen and unauthorized transactions are made by using the card as both a debit card and a credit card, Regulation E will apply to the unauthorized transactions in which the card was used as a debit card, and Regulation Z will apply to the unauthorized transactions in which the card was used as a credit card.

### Procedures for Resolving Errors— Section 205.11

This section defines “error” and describes the steps the consumer must take when asserting an error in order to receive the protection of the EFTA and Regulation E, and the procedures that a financial institution must follow to resolve an alleged error.

An *error* includes any of the following:

- An unauthorized EFT;
- An incorrect EFT to or from the consumer's account;
- The omission from a periodic statement of an EFT to or from the consumer's account that should have been included;
- A computational or bookkeeping error made by the financial institution relating to an EFT;
- The consumer's receipt of an incorrect amount of money from an electronic terminal;
- An EFT not identified in accordance with the requirements of sections 205.9 or 205.10(a); or
- A consumer's request for any documentation required by sections 205.9 or 205.10(a) or for additional information or clarification concerning an EFT. (Section 205.11(a)(1)).

The term “error” does not include

- A routine inquiry about the balance in the consumer's account or a request for duplicate copies of documentation or other information that is made only for tax or other record-keeping purposes. (Sections 205.11(a)(2)(i), (ii), and (iii)).
- The fact that a financial institution does not make a terminal receipt available for a transfer of \$15 or less in accordance with section 205.9(e). (Staff Commentary 205.11(a)-6).

A financial institution must comply with the error-resolution procedures in section 205.11 with respect to any oral or written notice of error from the consumer that

- The financial institution receives not later than 60 days after sending a periodic statement or other documentation first reflecting the alleged error (but see section 205.14 and 205.18);
- Enables the financial institution to identify the consumer's name and account number; and
- Indicates why the consumer believes the error exists, and, to the extent possible, the type, date, and amount of the error. (Section 205.11(b)(1)).

A financial institution may require a consumer to give written confirmation of an error within 10 business days of giving oral notice. The financial institution must provide the address where confirmation must be sent. (Section 205.11(b)(2)).

### *Error-Resolution Procedures*

After receiving a notice of error, the financial institution must

- Promptly investigate the oral or written allegation of error,
- Complete its investigation within 10 business days, (Section 205.11(c)(1))
- Report the results of its investigation within three business days after completing its investigation, and
- Correct the error within one business day after determining that an error has occurred.

The financial institution may take up to 45 calendar days (section 205.11(c)(2)) to complete its investigation provided it

- Provisionally credits the funds (including interest, where applicable) to the consumer's account within the 10-business-day period;
- Advises the consumer within two business days of the provisional crediting; and
- Gives the consumer full use of the funds during the investigation.

A financial institution need not provisionally

credit the account to take up to 45 calendar days to complete its investigation if the consumer fails to provide the required written confirmation of an oral notice of error, or if the notice of error involves an account subject to the margin requirements or other aspects of Regulation T (12 CFR 220). (Section 205.11(c)(2)(i)). However, where an error involves an unauthorized EFT, the financial institution must comply with the requirements of the provisions relating to unauthorized EFTs before holding the consumer liable, even if the consumer does not provide a notice of error within the time limits in section 205.11(b). (Staff Commentary 205.11(b)(1)-7).

When investigating a claim of error, the financial institution need only review its own records if the alleged error concerns a transfer to or from a third party, and there is no agreement between the financial institution and the third party for the type of EFT involved. (Section 205.11(c)(4)). However, the financial institution may not limit its investigation solely to the payment instructions where other information within the financial institution's records pertaining to a particular account may help to resolve a consumer's claim. (Staff Commentary 205.11(c)(4)-5).

If, after investigating the alleged error, the financial institution determines that an error has occurred, it shall promptly (within one business day after such determination) correct the error, including the crediting of interest if applicable. The financial institution shall provide within three business days of the completed investigation an oral or written report of the correction to the consumer and, as applicable, notify the consumer that the provisional credit has been made final. (Section 205.11(c)(2)(iii) and (iv)).

If the financial institution determines that no error occurred or that an error occurred in a different manner or amount from that described by the consumer, the financial institution must mail or deliver a written explanation of its findings within three business days after concluding its investigation. The explanation must include a notice of the consumer's rights to request the documents upon which the financial institution relied in making its determination. (Section 205.11(d)).

Upon debiting a provisionally credited amount, the financial institution shall notify the consumer of the date and amount of the debit and of the fact that the financial institution will honor (without charge) checks, drafts, or similar paper instruments payable to third parties and preauthorized debits for five business days after transmittal of the notice. The financial institution need honor only items that it would have paid if the provisionally credited funds had not been debited. Upon request from the consumer, the financial institution must promptly

mail or deliver to the consumer copies of documents upon which it relied in making its determination. (Section 205.11(d)(2)).

If a notice involves an error that occurred within 30 days after the first deposit to the account was made, the time periods are extended from 10 and 45 days, to 20 and 90 days, respectively. If the notice of error involves a transaction that was not initiated in a state or resulted from a point-of-sale debit card transaction, the 45-day period is extended to 90 days. (Section 205.11(c)(3)).

If a financial institution has fully complied with the investigation requirements, it generally does not need to reinvestigate if a consumer later reasserts the same error. However, it must investigate a claim of error asserted by a consumer following receipt of information provided pursuant to section 205.11(a)(1)(vii). (Section 205.11(e)).

## V. Receipts and Periodic Statements

### Documentation of Transfers— Section 205.9

#### *Electronic Terminal Receipts*

A receipt must be made available at the time the consumer initiates an EFT at an electronic terminal. However, a financial institution may program its electronic terminals to provide a receipt to only those consumers who elect to receive one. (Staff Commentary 205.9(a)-1). The receipt must include, as applicable,

- Amount of the transfer—a charge for making the transfer may be included in the amount, provided the charge is disclosed on the receipt and on a sign posted on or at the terminal.
- Date—the date the consumer initiates the transfer.
- Type of transfer and type of account—descriptions such as “withdrawal from checking” or “transfer from savings to checking” are appropriate. This is true even if the accounts are only similar in function to a checking account (such as a share draft or NOW account) or a savings account (such as a share account). If the access device used can only access one account, the type of account may be omitted. (Staff Commentaries 205.9(a)(3)-1; 205.9(3)-2; 205.9(3)-4; and 205.9(3)-5).
- Number or code identifying the consumer's account(s) or the access device used to initiate the transfer—the number and code need not exceed four digits or letters.
- Location of the terminal—The location of the terminal where the transfer is initiated or an

identification, such as a code or terminal number. If the location is disclosed, except in limited circumstances where all terminals are located in the same city or state, the receipt shall include the city and state or foreign country and one of the following:

- Street address of the terminal;
  - Generally accepted name for the location of the terminal (such as an airport, shopping center, or branch of a financial institution); or
  - Name of the entity (if other than the financial institution providing the statement) at whose place of business the terminal is located, such as a store, and the city, state, or foreign country. (Section 205.9(a)(5)).
- Name of any third party to or from whom funds are transferred—a code may be used to identify the party if the code is explained on the receipt. This requirement does not apply if the name of the party is provided by the consumer in a manner the terminal cannot duplicate on the receipt, such as on a payment stub. (Staff Commentary 205.9(a)(6)-1).

Receipts are not required for electronic EFTs of \$15 or less. (Section 205.9(e)).

### Periodic Statements

Periodic statements must be sent for each monthly cycle in which an EFT has occurred, and at least quarterly if no EFT has occurred. (Section 205.9(b)). For each EFT made during the cycle, the statement must include, as applicable,

- Amount of the transfer—if a charge was imposed at an electronic terminal by the owner or operator of the terminal, that charge may be included in the amount;
- Date the transfer was posted to the account;
- Type of transfer(s) and type of account(s) to or from which funds were transferred;
- For each transfer (except deposits of cash, or a check, draft, or similar paper instrument, to the consumer's account) initiated at an electronic terminal, the terminal location as required for the receipt under section 205.9(a)(5);
- Name of any third-party payee or payor;
- Account number(s);
- Total amount of any fees and charges, other than a finance charge as defined by Regulation Z, assessed during the period for (1) making EFTs, (2) the right to make EFTs, or (3) account maintenance;
- Balance in the account at the beginning and close of the statement period;

- Address and telephone number to be used by the consumer for inquiries or notice of errors. If the financial institution has elected to send the abbreviated error notice with every periodic statement, the address and telephone number may appear on that document; and
- If the financial institution has provided a telephone number which the consumer can use to find out whether or not a preauthorized transfer has taken place, that telephone number.

### Exceptions to the Periodic Statement Requirement for Certain Accounts

*Passbook accounts.* Where a consumer's passbook may not be accessed by an EFT other than preauthorized transfers to the account, a periodic statement need not be sent, provided that the financial institution updates the consumer's passbook or provides the required information on a separate document at the consumer's request. To update the passbook, the amount and date of each EFT made since the passbook was last presented must be listed. (Section 205.9(c)(1)(i)). For other accounts that may be accessed only by preauthorized transfers to the account, the financial institution must send a periodic statement at least quarterly. (Section 205.9(c)(1)(ii)).

*Transfers between accounts.* If a transfer occurs between two accounts of the consumer at the same financial institution, the transfer need only be documented for one of the two accounts. (Section 205.9(c)(2)). A preauthorized transfer between two accounts of the consumer at the same financial institution is subject to the section 205.9(c)(1) rule on preauthorized transfers and not the section 205.9(c)(2) rule on intra-institutional transfers. (Section 205.9(c)(3)).

*Documentation for foreign-initiated transfers.* If an EFT is initiated outside the United States, the financial institution need not provide a receipt or a periodic statement reflecting the transfer if it treats an inquiry for clarification or documentation as a notice of error. (Section 205.9(d)).

### Alternatives to Periodic Statements for Financial Institutions Offering Payroll Card Accounts—Section 205.18

This section provides an alternative to providing periodic statements for payroll card accounts if financial institutions make the account information available to consumers by specific means. In addition, this section clarifies how financial institutions that do not provide periodic statements for payroll card accounts can comply with the Regulation E requirements relating to initial disclosures, the annual error-resolution notice, liability limits, and the error-resolution procedures.

Typically, employers and third-party service

providers do not meet the definition of a “financial institution” subject to the regulation because they neither (i) hold payroll card accounts nor (ii) issue payroll cards and agree with consumers to provide EFT services in connection with payroll card accounts. However, to the extent an employer or a service provider undertakes either of these functions, it would be deemed a financial institution under the regulation. (Staff Commentary 205.18(a)-2).

#### Alternative to Periodic Statements

A financial institution does not need to furnish periodic statements required by section 205.9(b) if the financial institution makes available to the consumer

- The account balance, through a readily available telephone line;
- An electronic history of account transactions covering at least 60 days preceding the date the consumer electronically accesses the account; and
- A written history of the account transactions provided promptly in response to an oral or written request and covering at least 60 days preceding the date the financial institution receives the consumer’s request. (Section 205.18(b)(1)).

The history of account transactions must include the same type of information required on periodic statements under section 205.9(b). (Section 205.18(b)(2)).

#### Requirements to Comply with Regulation E

If a financial institution provides an alternative to periodic statements under section 205.18(b), it must comply with the following:

- Modify the initial disclosures under 205.7(b) by disclosing
  - A telephone number that the consumer may call to obtain the account balance; the means by which the consumer can obtain an electronic account history, such as the address of an Internet website; and a summary of the consumer’s right to receive a written account history upon request (in place of the summary of the right to receive a periodic statement required by section 205.7(b)(6)), including a telephone number to call to request a history. The disclosure required by this paragraph (c)(1)(i) may be made by providing a notice substantially similar to the notice contained in paragraph A-7(a) in Appendix A of Part 205.
  - A notice concerning error resolution that is substantially similar to the notice contained in paragraph A-7(b) in Appendix A, in place of

the notice required by section 205.7(b)(10).

- Provide an annual error-resolution notice that is substantially similar to the notice contained in paragraph (b) to A-7—Model Clauses for Financial Institutions Offering Payroll Card Accounts in Appendix A of Part 205, in place of the notice required by section 205.8(b). Alternatively, a financial institution may include on or with each electronic and written history provided in accordance with section 205.18(b)(1), a notice substantially similar to the abbreviated notice for periodic statements contained in paragraph A-3(b) in Appendix A, modified as necessary to reflect the error-resolution provisions set forth in this section.
- Limits on consumer liability
  - For purposes of section 205.6(b)(3), the 60-day period for reporting any unauthorized transfer shall begin on the earlier of
    - a. The date the consumer electronically accesses the consumer’s account under paragraph (b)(1)(ii) of this section, provided that the electronic history made available to the consumer reflects the transfer; or
    - b. The date the financial institution sends a written history of the consumer’s account transactions requested by the consumer under paragraph (b)(1)(iii) of this section in which the unauthorized transfer is first reflected.
  - A financial institution may limit the consumer’s liability for an unauthorized transfer as provided under section 205.6(b)(3) for transfers reported by the consumer within 120 days after the transfer was credited or debited to the consumer’s account.
- Comply with error-resolution requirements
  - An error notice is considered timely, and the financial institution must comply with the requirements of section 205.11, if the financial institution receives notice from the consumer no later than the earlier of
    - a. 60 days after the date the consumer electronically accesses the consumer’s account under paragraph (b)(1)(ii) of this section, provided that the electronic history made available to the consumer reflects the alleged error; or
    - b. 60 days after the date the financial institution sends a written history of the consumer’s account transactions requested by the consumer under paragraph (b)(1)(iii) of this section in which the alleged error is first reflected.
  - Alternatively, a financial institution complies

with the error-resolution requirements in section 205.11 if it investigates any oral or written notice of an error from the consumer that is received by the financial institution within 120 days after the transfer allegedly in error was credited or debited to the consumer's account.

## VI. Other Requirements

### Preauthorized Transfers—Section 205.10

A preauthorized transfer may be either a credit to, or a debit from, an account.

#### *Preauthorized Transfers to a Consumer's Account*

When an account is scheduled to be credited by a preauthorized EFT from the same payor at least once every 60 days, the financial institution must provide some form of notice to the consumer so that the consumer can find out whether or not the transfer occurred. (Section 205.10(a)). The notice requirement will be satisfied if the payor provides notice to the consumer that the transfer has been initiated. If the payor does not provide notice, the financial institution must adopt one of three alternative procedures for giving notice.

- The financial institution may give the consumer oral or written notice within two business days after a preauthorized transfer occurs.
- The financial institution may give the consumer oral or written notice, within two business days after the preauthorized transfer was scheduled to occur, that the transfer did not occur.
- The financial institution may establish a readily available telephone line<sup>6</sup> that the consumer may call to find out whether a preauthorized transfer has occurred. If the financial institution selects this option, the telephone number must be disclosed on the initial disclosures and on each periodic statement.

The financial institution need not use any specific language to give notice but may not simply provide the current account balance. (Staff Commentary 205.10(a)(1)-1). The financial institution may use different methods of notice for different types of preauthorized transfers and need not offer consum-

ers a choice of notice methods. (Staff Commentary 205.10(a)(1)-2).

The financial institution that receives a preauthorized transfer must credit the consumer's account as of the day the funds are received. (Section 205.10(a)(3)).

#### *Preauthorized Transfers from a Customer's Account*

Preauthorized transfers from a consumer's account may only be authorized by the consumer in writing and signed or similarly authenticated by the consumer. (Section 205.10(b)). Signed, written authorizations may be provided electronically, subject to the E-Sign Act. (Staff Commentary 205.10(b)-5). In all cases, the party that obtains the authorization from the consumer must provide a copy to the consumer. If a third-party payee fails to obtain an authorization in writing or fails to provide a copy to the consumer, the third-party payee and not the financial institution has violated Regulation E. (Staff Commentary 205.10(b)-2).

#### *Stop Payments*

Consumers have the right to stop payment of preauthorized transfers from accounts. The consumer must notify the financial institution orally or in writing at any time up to three business days before the scheduled date of the transfer. (Section 205.10(c)(1)). The financial institution may require written confirmation of an oral stop-payment order to be made within 14 days of the consumer's oral notification. If the financial institution requires a written confirmation, it must inform the consumer at the time of the oral stop-payment order that written confirmation is required and provide the address to which the confirmation should be sent. If the consumer fails to provide written confirmation, the oral stop-payment order ceases to be binding after 14 days. (Section 205.10(c)(2)).

#### *Notice of Transfers Varying in Amount*

If a preauthorized transfer from a consumer's account varies in amount from the previous transfer under the same authorization or the preauthorized amount, either the financial institution or the designated payee must send to the consumer a written notice, at least 10 days before the scheduled transfer date, of the amount and scheduled date of the transfer. (Section 205.10(d)(1)). The consumer may elect to receive notice only when the amount varies by more than an agreed amount or falls outside a specified range. (Section 205.10(d)(2)). The range must be an acceptable range that the consumer could reasonably anticipate. (Staff Commentary 205.10(d)(2)-1). The finan-

6. The telephone line must be "readily available" so that consumers calling to inquire about transfers are able to have their calls answered reasonably promptly during normal business hours. During the initial call in most cases and within two business days after the initial call in all cases, the financial institution should be able to verify whether the transfer was received. (Staff Commentary 205.10(a)(1)-5). Within its primary service area, a financial institution must provide a local or toll-free telephone number. (Staff Commentary 205.10(a)(1)-7).

cial institution does not violate Regulation E if the payee fails to provide sufficient notice. (Staff Commentary 205.10(d)-1).

### *Compulsory Use*

The financial institution may not make it a condition for an extension of credit that repayment will be by means of preauthorized EFT, except for credit extended under an overdraft credit plan or extended to maintain a specified minimum balance in the consumer's account. (Section 205.10(e)(1)). The financial institution may offer a reduced APR or other cost-related incentive for an automatic payment feature as long as the creditor offers other loan programs for the type of credit involved. (Staff Commentary 205.10(e)(1)-1).<sup>7</sup>

### Services Offered by Provider Not Holding Consumer's Account— Section 205.14

A person who provides EFT services to a consumer but does not hold the consumer's account is a service provider subject to section 205.14 if the person issues an access device that the consumer can use to access the account and no agreement exists between the person and the account-holding financial institution. Transfers initiated by a service provider are often cleared through an automated clearinghouse (ACH).

The responsibilities of the service provider are set forth in sections 205.14(b)(1) and (2). The duties of the account-holding financial institution with respect to the service provider are found in sections 205.14(c)(1) and (2).

### Electronic Fund Transfer of Government Benefits—Section 205.15

Section 205.15 contains the rules that apply to electronic benefit transfer (EBT) programs. It provides that government agencies must comply with modified rules on the issuance of access devices, periodic statements, initial disclosures, liability for unauthorized use, and error-resolution notices.

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7. This section also prohibits anyone from requiring the establishment of an account for receipt of EFTs with a particular financial institution either as a condition of employment or the receipt of a government benefit. (Section 205.10(e)(2)). However, the employer may require direct deposit of salary, as long as the employee may choose the financial institution that will accept the direct deposit, or limit direct deposits to one financial institution as long as the employee may choose to receive salary by other means (for example, check or cash). (Staff Commentary 205.10(e)(2)-1).

### VII. Relation to Other Laws— Section 205.12

This section describes the relationship between the EFTA and the Truth in Lending Act (TILA). The section also provides procedures for states to apply for exemptions from the requirements of the EFTA or Regulation E for any class of EFTs within the state.

The EFTA governs

- The issuance of debit cards and other access devices with EFT capabilities;
- The addition of EFT features to credit cards; and
- The issuance of access devices whose only credit feature is a pre-existing agreement to extend credit to cover account overdrafts or to maintain a minimum account balance.

The TILA governs

- The issuance of credit cards as defined in Regulation Z;
- The addition of a credit feature to a debit card or other access device; and
- The issuance of dual debit/credit cards, except for access devices whose only credit feature is a pre-existing agreement to cover account overdrafts or to maintain a minimum account balance.

The EFTA and Regulation E preempt inconsistent state laws, but only to the extent of the inconsistency. The Board is given the authority to determine whether or not a state law is inconsistent. A financial institution, state, or other interested party may request the Board to make such a determination. A state law will not be deemed inconsistent if it is more protective of the consumer than the EFTA or Regulation E. Upon application, the Board has the authority to exempt any state from the requirements of the Act or the regulation for any class of EFTs within a state, with the exception of the civil liability provision.

### VIII. Administrative Enforcement and Record Retention—Section 205.13

Section 917 of the EFTA sets forth the federal agencies responsible for enforcing compliance with the provisions of the Act.

#### Record Retention

Financial institutions must maintain evidence of compliance with the EFTA and Regulation E for at least two years. The agency supervising the financial institution may extend this period. The period may also be extended if the financial institution is subject to an action filed under

sections 910, 915 or 916(a) of the EFTA, which generally apply to the financial institution's liability under the EFTA and Regulation E. Persons subject to the EFTA who have actual notice that they are being investigated or subject to an enforcement proceeding must retain records until disposition of the proceeding.

Records may be stored on microfiche, microfilm, magnetic tape, or in any other manner capable of accurately retaining and reproducing the information.

## IX. Miscellaneous

EFTA contains several additional provisions that are not directly reflected in the language of Regulation E. Most significantly, 15 USC 1693l provides that the consumer may not waive by agreement any right conferred, or cause of action created, by the EFTA. However, the consumer and another person may provide by agreement greater consumer protections or additional rights or remedies than those provided by EFTA. In addition, the consumer may sign a waiver in settlement of a dispute.

If a third-party payee has agreed to accept payment by EFT, the consumer's obligation to pay is suspended during any period in which a system malfunction prevents an EFT from occurring. (15 USC 1693j). However, the payee may avoid that suspension by making a written request for payment by means other than EFT.

Failure to comply with the requirements of EFTA can result in civil and criminal liability, as outlined in 15 USC 1693m and 15 USC 1693n. Financial institutions may also be liable for damages under 15 USC 1693h due to failure to complete an EFT or failure to stop a preauthorized transfer when instructed to do so.

### Model Disclosure Clauses and Forms (12 CFR 205, Appendix A)

Appendix A of Regulation E contains model clauses and forms that financial institutions may use to comply with the disclosure requirements of

Regulation E. Use of the model forms is optional and a financial institution may make certain changes to the language or format of the model forms without losing the protection from civil and criminal liability under sections 915 and 916 of the EFTA. The model forms are

- A-1 Model Clauses for Unsolicited Issuance (Section 205.5(b)(2))
- A-2 Model Clauses for Initial Disclosures (Section 205.5(b)(2))
- A-3 Model Forms for Error Resolution Notice (Section 205.7(b)(10) and 205.8(b))
- A-4 Model Form for Service-Providing Institutions (Section 205.14(b)(1)(ii))
- A-5 Model Forms for Government Agencies (Section 205.15(d)(1) and(2))
- A-6 Model Clauses for Authorizing One-Time Electronic Fund Transfers Using Information from a Check (Section 205.3(b)(2))
- A-7 Model Clauses for Financial Institutions Offering Payroll Card Accounts (Section 205.18(c))
- A-8 Model Clause for Electronic Collection of Returned Item Fees (Section 205.3(b)(3))

### Laws

- 15 USC 1693 et. seq., Electronic Funds Transfer Act
- 15 USC 7001 et. seq., Electronic Signatures in Global and National Commerce

### Regulations

- 12 CFR 205, Electronic Funds Transfer





# Regulation E

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

1. To determine the financial institution's compliance with Regulation E.
2. To assess the quality of the financial institution's compliance risk management systems and its policies and procedures for implementing Regulation E.
3. To determine the reliance that can be placed on the financial institution's internal controls and procedures for monitoring the financial institution's compliance with Regulation E.
4. To direct corrective action when violations of law are identified or when the financial institution's policies or internal controls are deficient.

### EXAMINATION PROCEDURES

#### Management and Policy-Related Examination Procedures

1. Through a review of all written policies and procedures, management's self-assessments, customer complaints, prior examination reports, and any compliance audit material, including work papers and reports, determine whether
  - a. The scope of the audit addresses all provisions as applicable.
  - b. Management has taken corrective actions to follow up on previously identified deficiencies.
  - c. The testing includes samples covering all product types and decision centers.
  - d. The work performed is accurate.
  - e. Significant deficiencies and their causes are included in reports to management and/or to the Board of Directors.
  - f. The frequency of review is appropriate.
2. Through discussions with management and review of available information, determine whether the financial institution's internal controls are adequate to ensure compliance with the area of Regulation E under review. Consider the following:
  - a. Organization charts
  - b. Process flowcharts
  - c. Policies and procedures
  - d. Account documentation
  - e. Checklists

- f. Computer program documentation
3. Through a review of the financial institution's training materials, determine whether
    - a. The financial institution provides appropriate training to individuals responsible for Regulation E compliance and operational procedures.
    - b. The training is comprehensive and covers the various aspects of Regulation E that apply to the individual financial institution's product offerings and operations.

#### Transaction-Related Examination Procedures

If upon conclusion of the management and policy-related examination procedures, procedural weaknesses or other risks requiring further investigation are noted, conduct transaction testing, as necessary, using the following examination procedures. Use examiner judgment in deciding the size of each sample of deposit account disclosures, notices, and advertisements. The sample size should be increased until confidence is achieved that all aspects of the financial institution's activities and policies that are subject to the regulation are reviewed sufficiently.

1. Obtain and review copies of the following:
  - a. Disclosure forms.
  - b. Account agreements.
  - c. Procedural manuals and written policies.
  - d. Merchant agreements.
  - e. Automated teller machine receipts and periodic statements.
  - f. Error-resolution statements/files.
  - g. Form letters used in case of errors or questions concerning an account.
  - h. Any agreements with third parties allocating compliance responsibilities.
  - i. Consumer complaint files.
2. Determine the extent and adequacy of the financial institution's policies, procedures, and practices for ensuring compliance with the regulation. In particular, verify that
  - a. Access devices are issued in compliance with the regulation (12 CFR 205.5).
  - b. Required disclosures are given at the time the account is opened or prior to the first EFT (12 CFR 205.4 and 205.7).

- c. Unauthorized transfer claims are processed in compliance with the regulation (12 CFR 205.6 and 205.11).
  - d. Liability for unauthorized transfer claims is assessed in compliance with the regulation (12 CFR 205.6).
  - e. Negligence is not a factor in determining customer liability. The deposit agreement may not impose greater liability than Regulation E provides but may provide for less consumer liability (12 CFR 205.6).
  - f. Preauthorized debits and credits comply with the regulation (12 CFR 205.10).
3. If the financial institution has changed the terms or conditions since the last examination that required a written notice to the customer, determine that the proper notice was provided in a timely manner (12 CFR 205.8(a)).
  4. Review a sample of periodic statements to determine that they contain sufficient information for the consumer to identify transactions adequately and that they otherwise comply with regulatory requirements (12 CFR 205.9).
  5. Verify that the financial institution does not require compulsory use of EFTs, except as authorized (12 CFR 205.10(e)).
  6. Review documents relating to a sample of unauthorized transfers, lost or stolen ATM cards, and EFT consumer complaints, and their respective periodic statements. During this review,
    - a. Evaluate compliance with the financial institution's error-resolution procedures to isolate any apparent deficiencies in the financial institution's operations and to ensure that policies for unauthorized transfers are followed (12 CFR 205.6 and 205.11).
    - b. Determine whether alleged errors are investigated and consumers are notified of the results within allotted time frames, and, when appropriate, whether the account is provisionally recredited (12 CFR 205.11(c)).
- c. Verify that the financial institution follows regulatory procedures after completing the investigation and determining either that an error occurred (12 CFR 205.11(c)(1)) or that no error occurred (12 CFR 205.11(d)).
7. Review a periodic statement for *each* type of account in which electronic fund transfers occur to make sure that the statements comply with the regulation's requirements (12 CFR 205.9(b)).
  8. Review ATM and point-of-sale transfer receipts to determine whether they provide a clear description of the transaction (12 CFR 205.9(a)).
  9. Determine that the financial institution is maintaining records of compliance for a period of not less than two years from the date disclosures are required to be made or an action is required to be made (12 CFR 205.13(b)).
  10. If the financial institution maintains payroll card accounts, review a sample of the payroll card accounts. If the financial institution does not provide periodic statements under 12 CFR 205.9(b) for these accounts, verify that the institution makes available the account balance by telephone, an electronic history of account transactions, and (upon request) a written history of account transactions (12 CFR 205.18(b)).
  11. If the financial institution maintains payroll card accounts, verify that the financial institution complies with the modified requirements with respect to the required initial disclosures, error-resolution notices, limitations on liability, and error-resolution procedures (12 CFR 205.18(c)).
  12. If the financial institution operates one or more ATMs for which it charges a fee for use, determine that the financial institution provides notice of the fee and the amount of the fee both on the machine and on the screen or paper before the consumer is committed to paying the fee (12 CFR 205.16).

# Regulation E

## Examination Checklist

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### 12 CFR 205.5—Issuance of Access Devices

- |  |     |    |    |
|--|-----|----|----|
| 1. Do the financial institution's policies, practices, and procedures allow that validated access devices are issued only  |     |    |    |
| a. In response to oral or written requests, [12 CFR 205.5(a)(1)] or  | Yes | No | NA |
| b. As a renewal or substitution for an accepted access device? [12 CFR 205.5(a)(2)].   | Yes | No | NA |
| 2. Do the financial institution's policies, practices, and procedures allow that unsolicited access devices are issued only when the devices are   |     |    |    |
| a. Not validated, [12 CFR 205.5(b)(1)]   | Yes | No | NA |
| b. Accompanied by a clear explanation that they are not validated and how they may be disposed of if validation is not desired, [12 CFR 205.5(b)(2)]   | Yes | No | NA |
| c. Accompanied by the initial disclosures required by 12 CFR 205.7, [12 CFR 205.5(b)(3)] and   | Yes | No | NA |
| d. Validated only in response to a consumer's request and after the financial institution has verified the consumer's identity by reasonable means (for example, photograph, fingerprint, personal visit, signature)? [12 CFR 205.5(b)(4) and Staff Commentary]. | Yes | No | NA |

### 12 CFR 205.6—Consumer Liability for Unauthorized Electronic Fund Transfers

- |  |     |    |    |
|--|-----|----|----|
| 3. Does the financial institution impose liability on the consumer for unauthorized transfers only [12 CFR 205.6(a)]   |     |    |    |
| a. If any access device that was used was an accepted access device; and   | Yes | No | NA |
| b. If the institution has provided a means to identify the consumer to whom it was issued; and   | Yes | No | NA |
| c. If the institution has provided the disclosures required by section 205.7(b)(1), (2), and (3)?  | Yes | No | NA |
| 4. Does the financial institution <i>not</i> rely on consumer negligence or the deposit agreement to impose greater consumer liability for unauthorized EFTs than is permitted under Regulation E? [Staff Commentaries 205.6(b)-1 and -2]  | Yes | No | NA |
| 5. If a consumer notifies the financial institution within two business days after learning of the loss or theft of an access device, does the financial institution limit the consumer's liability for unauthorized EFTs to the lesser of \$50 or actual loss? [12 CFR 205.6(b)(1)]                               | Yes | No | NA |
| 6. If a consumer does not notify the financial institution within two business days after learning of the loss or theft of an access device, does the institution limit the consumer's liability for unauthorized EFTs to the lesser of \$500 or the sum of [12 CFR 205.6(b)(2)]                                   |     |    |    |
| a. \$50 or the amount of unauthorized EFTs that occurred within the two business days, whichever is less; <i>plus</i>  | Yes | No | NA |
| b. The amount of unauthorized EFTs that occurred after the close of two business days and before notice to the financial institution (provided the financial institution establishes that these transfers would not have occurred had the consumer notified the financial institution within that two-day period)? | Yes | No | NA |

7. If a consumer notifies the financial institution of an unauthorized EFT within 60 calendar days of transmittal of the periodic statement upon which the unauthorized EFT appears, does the financial institution not hold the consumer liable for the unauthorized transfers that occur after the 60-day period? [12 CFR 205.6(b)(3)]	Yes	No	NA
8. If a consumer does not notify the financial institution of an unauthorized EFT within 60 calendar days of transmittal of the periodic statement upon which the unauthorized EFT appears, does the financial institution ensure that the consumer's liability does not exceed the amount of the unauthorized transfers that occur after the close of the 60 days and before notice to the financial institution, if the financial institution establishes that the transfers would not have occurred had timely notice been given? [12 CFR 205.6(b)(3)]	Yes	No	NA
9. If a consumer notifies the financial institution of an unauthorized EFT within the time frames discussed in question 7 or 8 and the consumer's access device is involved in the unauthorized transfer, does the financial institution hold the consumer liable for amounts as set forth in 12 CFR 205.6(b)(1) or (2) (discussed in questions 5 and 6)? [12 CFR 205.6(b)(3)]	Yes	No	NA
NOTE: The first two tiers of liability (as set forth in 12 CFR 205.6(b)(1) and (2) and discussed in questions 5 and 6) do not apply to unauthorized transfers from a consumer's account made without an access device. [Staff Commentary 205.6(b)(3)-2]			
10. Does the financial institution extend the 60-day time period by a reasonable amount, if the consumer's delay in notification was due to extenuating circumstance? [12 CFR 205.6(b)(4)]	Yes	No	NA
11. Does the financial institution consider notice to be made when the consumer takes steps reasonably necessary to provide the institution with pertinent information, whether or not a particular employee or agent of the institution actually received the information? [12 CFR 205.6(b)(5)(i)]	Yes	No	NA
12. Does the financial institution allow the consumer to provide notice in person, by telephone, or in writing? [12 CFR 205.6(b)(5)(ii)]	Yes	No	NA
13. Does the financial institution consider written notice to be given at the time the consumer mails or delivers the notice for transmission to the institution by any other usual means? [12 CFR 205.6(b)(5)(iii)]	Yes	No	NA
14. Does the financial institution consider notice given when it becomes aware of circumstances leading to the reasonable belief that an unauthorized transfer to or from the consumer's account has been or may be made? [12 CFR 205.6(b)(5)(iii)]	Yes	No	NA
15. Does the financial institution limit the consumer's liability to a lesser amount than provided by 12 CFR 205.6, when state law or an agreement between the consumer and the financial institution provide for such an amount? [12 CFR 205.6(b)(6)]	Yes	No	NA

## 12 CFR 205.7—Initial Disclosures

16. Does the financial institution provide the initial disclosures at the time a consumer contracts for an EFT service or before the first EFT is made involving the consumer's account? [12 CFR 205.7(a)]	Yes	No	NA
17. Do the financial institution's initial disclosures provide the following information, as applicable:			
a. A summary of the consumer's liability for unauthorized transfers under 12 CFR 205.6 or under state or other applicable law or agreement. [12 CFR 205.7(b)(1)]	Yes	No	NA

b. The telephone number and address of the person or office to be notified when the consumer believes that an unauthorized EFT has been or may be made. [12 CFR 205.7(b)(2)]	Yes	No	NA
c. The financial institution's business days. [12 CFR 205.7(b)(3)]	Yes	No	NA
d. The type of EFTs the consumer may make and any limits on the frequency and dollar amount of transfers. (If details on the limits on frequency and dollar amount are essential to maintain the security of the system, they need not be disclosed.) [12 CFR 205.7(b)(4)]	Yes	No	NA
e. Any fees imposed by the financial institution for EFTs or for the right to make transfers. [12 CFR 205.7(b)(5)]	Yes	No	NA
f. A summary of the consumer's right to receive receipts and periodic statements, as provided in 12 CFR 205.9, and notices regarding preauthorized transfers, as provided in 12 CFR 205.10(a) and 205.10(d). [12 CFR 205.7(b)(6)]	Yes	No	NA
g. A summary of the consumer's right to stop payment of a preauthorized EFT and the procedure for placing a stop-payment order, as provided in 12 CFR 205.10(c). [12 CFR 205.7(b)(7)]			
h. A summary of the financial institution's liability to the consumer for its failure to make or to stop certain transfers under the EFTA. [12 CFR 205.7(b)(8)]	Yes	No	NA
i. The circumstances under which the financial institution, in the ordinary course of business, may disclose information to third parties concerning the consumer's account. [12 CFR 205.7(b)(9)]	Yes	No	NA
j. An error-resolution notice that is substantially similar to the Model Form A-3 in Appendix A. [12 CFR 205.7(b)(10)]	Yes	No	NA
k. A notice that a fee may be imposed by an ATM operator (as defined in section 205.16(a)) when the consumer initiates an EFT or makes a balance inquiry and by any network used to complete the transaction. [12 CFR 205.7(b)(11)]	Yes	No	NA
18. Does the financial institution provide disclosures at the time a new EFT service is added, if the terms and conditions of the service are different than those initially disclosed? [12 CFR 205.7(c)]	Yes	No	NA

### 12 CFR 205.8—Change-in-Terms Notice and Error-Resolution Notice

19. If the financial institution made any changes in terms or conditions required to be disclosed under section 205.7(b) that would result in increased fees, increased liability, fewer types of available EFTs, or stricter limits on the frequency or dollar amount of transfers, does the financial institution provide a written notice to consumers at least 21 days prior to the effective date of such change? [12 CFR 205.8(a)]	Yes	No	NA
20. Does the financial institution provide either the long form error-resolution notice at least once every calendar year or the short form error-resolution notice on each periodic statement? [12 CFR 205.8(b)]	Yes	No	NA

### 12 CFR 205.9—Receipts at Electronic Terminals; Periodic Statements

21. Does the financial institution make receipts available to the consumer at the time the consumer initiates an EFT at an electronic terminal? The financial institution is exempt from this requirement for EFTs of \$15 or less. [12 CFR 205.9(a) and (e)]	Yes	No	NA
22. Do the receipts contain the following information, as applicable:			
a. The amount of the transfer, [12 CFR 205.9(a)(1)]	Yes	No	NA

b. The date the transfer was initiated, [12 CFR 205.9(a)(2)]	Yes	No	NA
c. The type of transfer and the type of account to or from which funds were transferred, [12 CFR 205.9(a)(3)]	Yes	No	NA
d. A number or code that identifies the consumer's account or the access device used to initiate the transfer, [12 CFR 205.9(a)(4)]	Yes	No	NA
e. The terminal location where the transfer is initiated, [12 CFR 205.9(a)(5)]	Yes	No	NA
f. The name or other identifying information of any third party to or from whom funds are transferred? [12 CFR 205.9(a)(6)]	Yes	No	NA
23. Does the financial institution send a periodic statement for each monthly cycle in which an EFT has occurred? If no EFT occurred, does the financial institution send a periodic statement at least quarterly? [12 CFR 205.9(b)]	Yes	No	NA
24. Does the periodic statement contain the following information, as applicable:			
a. Transaction information for each EFT occurring during the cycle, including the amount of transfer, date of transfer, type of transfer, terminal location, and name of any third-party transferor or transferee, [12 CFR 205.9(b)(1)]	Yes	No	NA
b. Account number, [12 CFR 205.9(b)(2)]	Yes	No	NA
c. Fees, [12 CFR 205.9(b)(3)]	Yes	No	NA
d. Account balances, [12 CFR 205.9(b)(4)]	Yes	No	NA
e. Address and telephone number for inquiries, [12 CFR 205.9(b)(5)]	Yes	No	NA
f. Telephone number to ascertain preauthorized transfers, if the financial institution provides telephone notice under 12 CFR 205.10(a)(1)(iii)? [12 CFR 205.9(b)(6)]	Yes	No	NA

## 12 CFR 205.10—Preauthorized Transfers

25. If a consumer's account is to be credited by a preauthorized EFT from the same payor at least once every 60 days (and the payor does not already provide notice to the consumer that the transfer has been initiated) [12 CFR 205.10(a)(2)], does the financial institution			
a. Provide oral or written notice, within two business days, after the transfer occurs, [12 CFR 205.10(a)(1)(i)] or	Yes	No	NA
b. Provide oral or written notice, within two business days after the transfer was scheduled to occur, that the transfer did or did not occur, [12 CFR 205.10(a)(1)(ii)] or	Yes	No	NA
c. Provide a readily available telephone line that the consumer can call to determine if the transfer occurred and disclose the telephone number on the initial disclosure of account terms and on each periodic statement? [12 CFR 205.10(a)(1)(iii)]	Yes	No	NA
26. Does the financial institution credit the amount of a preauthorized transfer as of the date the funds for the transfer are received? [12 CFR 205.10(a)(3)]	Yes	No	NA
27. Does the financial institution ensure that an authorization is obtained for preauthorized transfers from a consumer's account by a written, signed, or similarly authenticated authorization, and is a copy of the authorization provided to the consumer? [12 CFR 205.10(b)]	Yes	No	NA
28. Does the financial institution allow the consumer to stop payment on a preauthorized EFT by oral or written notice at least three business days before the scheduled date of the transfer? [12 CFR 205.10(c)(1)]	Yes	No	NA
29. If the financial institution requires that consumers give written confirmation of an oral stop-payment order within 14 days,			

<p>a. Does the financial institution inform consumers, at the time they give oral notification, of the requirement and provide the address where they must send the written confirmation?</p> <p style="margin-left: 40px;">NOTE: An oral stop-payment order ceases to be binding after 14 days if consumers fail to provide the required written confirmation. [12 CFR 205.10(c)(2)]</p>	<p>Yes</p>	<p>No</p>	<p>NA</p>
<p>30. Does the financial institution inform, or ensure that third-party payees inform, the consumer of the right to receive notice of all varying transfers?</p> <p style="margin-left: 20px;"><i>or</i></p> <p style="margin-left: 40px;">Does the financial institution give the consumer the option of receiving notice only when a transfer falls outside a specified range of amounts or differs from the most recent transfer by an agreed-upon amount? [12 CFR 205.10(d)(2)]</p>	<p>Yes</p>	<p>No</p>	<p>NA</p>
<p>31. If the financial institution or third-party payee is obligated to send the consumer written notice of the EFT of a varying amount, does the financial institution ensure that</p> <p style="margin-left: 20px;">a. The notice contains the amount and date of transfer,</p> <p style="margin-left: 20px;">b. The notice is sent at least 10 days before the scheduled date of transfer? [12 CFR 205.10(d)(1)]</p>	<p>Yes</p>	<p>No</p>	<p>NA</p>
<p>32. Does the financial institution not condition an extension of credit to a consumer on the repayment of loans by preauthorized EFT, except for credit extended under an overdraft credit plan or extended to maintain a specified minimum balance in the consumer's account? [12 CFR 205.10(e)(1)]</p>	<p>Yes</p>	<p>No</p>	<p>NA</p>
<p>33. Does the financial institution not require a consumer to establish an account for EFTs with a particular institution as a condition of employment or receipt of government benefits? [12 CFR 205.10(e)(2)]</p>	<p>Yes</p>	<p>No</p>	<p>NA</p>

**12 CFR 205.11—Procedures for Resolving Errors**

<p>34. Does the financial institution have procedures to investigate and resolve all oral or written notices of error received no later than 60 days after the institution sends the periodic statement or provides passbook documentation? [12 CFR 205.11(b)(2)]</p>	<p>Yes</p>	<p>No</p>	<p>NA</p>
<p>35. If the financial institution requires written confirmation of an error within 10 business days of an oral notice, does the financial institution inform the consumer of this requirement and provide the address where the written confirmation must be sent? [12 CFR 205.11(b)(2)]</p>	<p>Yes</p>	<p>No</p>	<p>NA</p>
<p>36. Does the financial institution have procedures to investigate and resolve alleged errors within 10 business days, except as otherwise provided in 12 CFR 205.11(c)? [12 CFR 205.11(c)(1)]</p> <p style="margin-left: 40px;">NOTE: The time period is extended in certain circumstances. [12 CFR 205.11(c)(3)]</p>	<p>Yes</p>	<p>No</p>	<p>NA</p>
<p>37. Does the financial institution report investigation results to the consumer within three business days after completing its investigation and correct any error within one business day after determining that an error occurred? [12 CFR 205.11(c)(1)]</p>	<p>Yes</p>	<p>No</p>	<p>NA</p>
<p>38. If the financial institution is unable to complete its investigation within 10 business days, does the financial institution have procedures to investigate and resolve alleged errors within 45 calendar days of receipt of a notice of error, and</p>			

a. Does the financial institution provisionally credit the consumer's account in the amount of the alleged error (including interest, if applicable) within 10 business days of receiving the error notice (however, if the financial institution requires, but does not receive, written confirmation within 10 business days, the financial institution is not required to provisionally credit the consumer's account)?	Yes	No	NA
b. Within two business days after granting any provisional credit, does the financial institution inform the consumer of the amount and date of the provisional credit and give the consumer full use of the funds during the investigation?	Yes	No	NA
c. Within one business day after determining that an error occurred, does the financial institution correct the error? and	Yes	No	NA
d. Does the financial institution report the results to the consumer within three business days after completing its investigation, including, if applicable, notice that a provisional credit has been made final? [12 CFR 205.11(c)]	Yes	No	NA
NOTE: The time period is extended in certain circumstances. [12 CFR 205.11(c)(3)]			
39. If a billing error occurred, does the financial institution not impose a charge related to any aspect of the error-resolution process? [Staff Commentary 205.11(c)-3]	Yes	No	NA
40. If the financial institution determines that no error occurred (or that an error occurred in a manner or amount different from that described by the consumer), does the financial institution send a written explanation of its findings to the consumer and note the consumer's right to request the documents the financial institution used in making its determination? [12 CFR 205.11(d)(1)]	Yes	No	NA
41. When the financial institution determines that no error (or a different error) occurred, does the financial institution notify the consumer of the date and amount of the debiting of the provisionally credited amount and the fact that the financial institution will continue to honor checks and drafts to third parties and preauthorized transfers for five business days (to the extent that they would have been paid if the provisionally credited funds had not been debited)? [12 CFR 205.11(d)(2)]	Yes	No	NA
<b>12 CFR 205.13—Record Retention</b>			
42. Does the financial institution maintain evidence of compliance with the requirements of the EFTA and Regulation E for a period of two years? [12 CFR 205.13(b)]	Yes	No	NA
<b>12 CFR 205.16—Disclosures at Automated Teller Machines (ATMs)</b>			
43. If the financial institution operates an ATM and imposes a fee on a consumer for initiating an EFT or balance inquiry, does the financial institution provide notice that a fee will be imposed and disclose the amount of the fee? [12 CFR 205.16(b)]	Yes	No	NA
44. Does the financial institution post the notice required by section 205.16(b) in a prominent and conspicuous location on or at the ATM? [12 CFR 205.16(c)(1)]	Yes	No	NA
45. Does the financial institution provide the notice required by section 205.16(b) either by showing it on the ATM screen or by providing it on paper before the consumer is committed to paying a fee? [12 CFR 205.16(c)(2)]	Yes	No	NA



## 12 CFR 205.18—Payroll Card Accounts

46. If the financial institution offers payroll card accounts, does the financial institution *either* provide periodic statements as required by 12 CFR 205.9(b) or make available to the consumer:
- |   |     |    |    |
|---|-----|----|----|
| a. The account balance, through a readily available telephone line, <i>and</i>  | Yes | No | NA |
| b. An electronic history of the consumer's account transactions, such as through an Internet website, that covers at least 60 days preceding the date the consumer electronically accesses the account, <i>and</i>  | Yes | No | NA |
| c. A written history of the consumer's account transactions that is provided promptly in response to an oral or written request and that covers at least 60 days preceding the date the financial institution receives the consumer's request? [12 CFR 205.18(b)] | Yes | No | NA |
- NOTE: The history of account transactions must include the information set forth in section 205.9(b).
47. Does the financial institution provide initial disclosures that include, at a minimum,
- |   |     |    |    |
|---|-----|----|----|
| a. A telephone number that the consumer may call to obtain the account balance, the means by which the consumer can obtain an electronic account history, such as the address of an Internet website, and a summary of the consumer's right to receive a written account history upon request, including a telephone number to call to request a history, and | Yes | No | NA |
| b. A notice concerning error resolution? [12 CFR 205.18(c)(1)]  | Yes | No | NA |
48. Does the financial institution provide an annual notice concerning error resolution or, alternatively, an abbreviated notice with each electronic and written history? [12 CFR 205.18(c)(2)]
- |     |    |    |
|-----|----|----|
| Yes | No | NA |
|-----|----|----|
49. Does the financial institution begin the 60-day period for reporting any unauthorized transfer under 12 CFR 205.6(b)(3) on the earlier of (1) the date the consumer electronically accesses the consumer's account provided that the electronic history made available to the consumer reflects the transfer; or (2) the date the financial institution sends a written history of the consumer's account transactions requested by the consumer in which the unauthorized transfer is first reflected? [12 CFR 205.18(c)(3)]
- |     |    |    |
|-----|----|----|
| Yes | No | NA |
|-----|----|----|
- NOTE: A financial institution may comply with the provision above by limiting the consumer's liability for an unauthorized transfer as provided under 12 CFR 205.6(b)(3) for any transfer reported by the consumer within 120 days after the transfer was credited or debited to the consumer's account.
50. Does the financial institution comply with the error-resolution requirements in response to an oral or written notice of an error from the consumer that is received by the earlier of (1) 60 days after the date the consumer electronically accesses the consumer's account provided that the electronic history made available to the consumer reflects the alleged error; or (2) 60 days after the date the financial institution sends a written history of the consumer's account transactions requested by the consumer in which the alleged error is first reflected? [12 CFR 205.18(c)(4)]
- |     |    |    |
|-----|----|----|
| Yes | No | NA |
|-----|----|----|
- NOTE: The financial institution may comply with the requirements for resolving errors by investigating any oral or written notice of an error from the consumer that is received by the institution within 120 days after the transfer allegedly in error was credited or debited to the consumer's account.

# Regulations Q and D

## Interest on Demand Deposits/Reserve Requirements

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Regulation Q (Prohibition against Payment of Interest on Demand Deposits) and Regulation D (Reserve Requirements of Depository Institutions) are two of the four regulations that examiners need to refer to when conducting the deposit operations segment of consumer compliance examinations. The other two regulations—Regulation CC (Availability of Funds and Collection of Checks) and Regulation DD (Truth in Savings)—are covered in subsequent chapters.

Regulation Q contains only a couple of important definitions. Regulation D, besides giving additional definitions, lays out rules governing such topics as penalties for early withdrawal and customer notices of intent to withdraw funds.

### Background

Regulation Q originated in the 1930s as part of a congressional response to banking practices and problems encountered during the Depression. By the late 1970s and early 1980s, new types of accounts—such as money market mutual funds issued by investment companies and securities firms that were not subject to federal interest rate regulation—were giving commercial banks stiff competition for funds. In response to both bankers' concerns about the competition from these unregulated deposit accounts and the deregulatory environment that prevailed at the time, Congress passed the Depository Institutions Deregulation Act of 1980, with the purpose of eliminating all federal interest rate ceilings on deposit accounts within six years. The last remaining interest rate ceilings were removed in March 1986, and most of the remaining provisions of Regulation Q were subsequently transferred to Regulation D.

Today, Regulation Q is relatively short and includes only the definition of "interest" and the prohibition against the payment of interest on demand deposits. Regulation D now contains definitions for the various categories of deposit accounts (transaction, demand, time, and savings) and places certain types of accounts, such as NOW accounts and money market deposit accounts, within those categories. Regulation D also provides for mandatory penalties for early withdrawals from time deposits.

Technically, Regulation D is a monetary policy regulation, not a consumer regulation. It specifies how depository institutions must classify different types of deposit accounts for the purpose of complying with reserve requirements, an integral

tool in implementing monetary policy.<sup>1</sup>

### Definitions

Two key terms are referred to in the definitions of types of accounts:

- *Interest*—"Any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit. A member bank's absorption of expenses incident to providing a normal banking function or its forbearance from charging a fee in connection with such a service is not considered a payment of interest." (Regulation Q, section 217.2(d))
- *Natural person*—"An individual or a sole proprietorship. The term does not mean a corporation owned by an individual, a partnership or other association." (Regulation D, section 204.2(g))

### Types of Accounts Covered

Regulation D defines *deposit* and divides deposit accounts into two categories—transaction and nontransaction accounts. Transaction accounts are the primary vehicle for calculating reserve requirements.

#### Transaction Accounts

A *transaction account* is an account from which the depositor or account holder is permitted to "make transfers or withdrawals by negotiable or transferable instrument, payment order of withdrawal, telephone transfer, or other similar device for the purpose of making payments or transfers to third persons or others or from which the depositor may make third-party payments at an automated teller machine or a remote service unit, or other electronic device . . . ." The following types of accounts are transaction accounts (section 204.2(e)):

- Demand deposit accounts
- NOW accounts
- ATS accounts

Savings deposit accounts are specifically excluded from the definition of transaction account, even though they permit third-party transfers.

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1. All depository institutions, including commercial banks, savings banks, savings and loan associations, credit unions, and agencies and branches of foreign banks located in the United States, are subject to reserve requirements. Required reserves are maintained either in the form of vault cash or as non-interest-bearing balances at a Federal Reserve Bank or a correspondent.

Transaction accounts have the following characteristics:

- Limited to demand, NOW, and ATS accounts
- Permit a depositor or account holder to make unlimited transfers or payments to third parties
- Permit a depositor to make unlimited transfers between accounts of the same depositor at the same institution

### *Demand Deposit Accounts*

Demand deposit accounts are payable on demand, or on less than seven days' notice. They generally have no maturity period and do not require the account holder to give notice of the intent to withdraw funds. If they do require notice of intent to withdraw funds, the notice period must be less than seven days and the requirement must be stated in the deposit contract. Both businesses and consumers may hold demand accounts. There are no eligibility restrictions on this type of account.

Demand deposits include deposits that for some reason have been reclassified as demand deposits—for example, matured certificates of deposit and savings deposits for which the transfer or withdrawal limitations have been exceeded.

Demand deposit accounts have the following characteristics:

- No maturity period (or maturity period of less than seven days)
- Payable on demand (or on less than seven days' notice)
- May not be interest-bearing
- No limit on the number of withdrawals or transfers an account holder may make
- No eligibility requirements

### *NOW Accounts*

NOW (negotiable order of withdrawal) accounts allow unlimited transactions, and they are classified as transaction accounts for purposes of reserve requirements. They share certain characteristics with savings deposit accounts, in that banks must reserve the right to require seven days' notice of intent to withdraw funds from NOW accounts (in practice, this right is rarely, if ever, exercised). Unlike savings deposit accounts, however, NOW accounts are available only to individuals; sole proprietorships; governmental units; and corporations, partnerships, associations, and organizations that are operated primarily for religious, philanthropic, charitable, educational, fraternal, or other similar purposes and not for profit.

Because NOW accounts are transaction accounts, the funds in a NOW account may be accessed in

several ways. For example, account holders may use negotiable instruments (checks), drafts, telephonic or electronic orders or instructions, or other similar devices to make payments or transfers to third persons or to others. The account holder may make an unlimited number of transfers to another of his or her accounts at the same institution.

NOW accounts have the following characteristics:

- Have no maturity date
- Bank must reserve the right to require at least seven days' prior written notice of intent to withdraw or transfer funds
- May be interest-bearing
- Permit unlimited transactions (transfers and withdrawals)
- May be accessed by check, draft, telephonic or electronic order or instruction, or other similar instrument to
  - Pay third parties or others
  - Transfer funds to another of the depositor's accounts at the same institution
- May be held only by individuals, sole proprietorships, governmental units, and nonprofit organizations
- Are classified as transaction accounts under Regulation D

### *ATS Accounts*

ATS (automatic transfer service) accounts, which are classified as transaction accounts for reserve requirement purposes, are accounts that provide for transfers or withdrawals to be made automatically to the bank itself or to another of the depositor's accounts at the same institution. ATS accounts were relatively common in the past but are rarely seen today. As with NOW accounts and savings deposit accounts, banks must reserve the right to require seven days' notice of intent to withdraw funds from ATS accounts. Unlike NOW accounts and savings deposit accounts, eligibility for ATS accounts is limited to individuals (including sole proprietorships). Businesses, governmental units, and nonprofit organizations are not eligible for ATS accounts.

ATS accounts have the following characteristics:

- Must reserve the right to require at least seven days' notice of intent to withdraw funds
- Provide for automatic transfers between at least two accounts at the same financial institution
- Eligibility limited to individuals (including sole proprietorships)
- Are classified as transaction accounts under Regulation D

## Nontransaction Accounts

### *Time Deposit Accounts*

Time deposit accounts have a maturity of at least seven days from the date of deposit. They may be payable on a specified date not less than seven days after the date of deposit or after the expiration of a specified period of time not less than seven days after the date of deposit (for example, thirty days after the date of deposit). Or they may be payable upon receipt of written notice from the depositor (required in the contract) not less than seven days prior to withdrawal. If funds are withdrawn from a time deposit account within six days of the date of deposit or within six days of the most recent partial withdrawal, the specified early withdrawal penalty must be imposed (see “Early Withdrawal Penalties,” below). There are no restrictions on who may hold a time deposit account.

Club accounts, such as Christmas or vacation club accounts, are considered time deposit accounts. Generally, funds are deposited into club accounts under a written contract that prohibits withdrawal until a certain number of deposits have been made during a period of not less than three months (even though some of the deposits may be made within six days from the end of the period).

Time deposits may be negotiable or nonnegotiable, transferable or nontransferable. They may be represented by a certificate, instrument, passbook, statement, book-entry notation, or otherwise. If the deposit is automatically renewable, that fact should be indicated on the certificate or other representation, along with the terms of renewal.

Time deposit accounts have the following characteristics:

- Must have a maturity of at least seven days from the date of deposit
- May require at least seven days’ prior written notice of intent to withdraw funds
- Must be subject to early withdrawal penalties if funds are withdrawn within six days of the date of deposit or the date of the immediately preceding partial withdrawal
- May be interest-bearing
- May be evidenced by a negotiable or nonnegotiable, transferable or nontransferable certificate, instrument, passbook, book entry, or other similar instrument
- Include club accounts (such as Christmas club or vacation club accounts)
- No eligibility requirements

**Early Withdrawal Penalties.** The presence (or absence) of an early withdrawal penalty differentiates time deposit accounts on the one hand and savings deposit accounts and transaction accounts

on the other hand. The early withdrawal penalty must be at least seven days’ simple interest on amounts withdrawn within the first six days after deposit or within six days after the most recent partial withdrawal. If funds are withdrawn more than six days after the date of deposit or more than six days after the most recent partial withdrawal, no interest penalty is required by federal law.

Penalties listed under Regulation D are the minimum federal penalties required by Regulation D and the Federal Reserve Act. Banks are free to impose greater penalties by contract with the depositor.

If a bank fails to impose early withdrawal penalties when they are required by Regulation D, the account ceases to be a time deposit account. If the account meets all the necessary requirements for a savings deposit account, the bank could reclassify it as such. Otherwise, the account may have to be reclassified as a transaction account.

The penalty provisions of time deposit accounts should be disclosed in writing to the customer at the time the account is opened. During the compliance examination, examiners should check that the bank has penalties in place that are at least equal to those required by Regulation D. As part of the examination, examiners should also verify the accuracy of the interest penalties assessed on a sample of time deposit accounts from which early withdrawals were permitted.

### *Savings Deposit Accounts*

Savings deposit accounts are a subcategory of “time deposits,” but they generally have no specified maturity period. They may be interest-bearing, with interest computed or paid daily, weekly, quarterly, or on any other basis.

The most significant feature of savings deposit accounts is the regulatory limit on the number of “convenient” transfers or withdrawals that may be made per month (or per statement cycle of at least four weeks) from the account. A depositor may make no more than six “convenient” transfers per month from a savings deposit account, and no more than three of these transfers may be made by check, debit card, or similar order made by the depositor and payable to third parties. “Convenient” transfers, for purposes of this limit, include preauthorized or automatic transfers (such as overdraft-protection transfers and direct bill payments) and transfers initiated by a depositor by telephone, facsimile, or computer. Other, less-convenient types of transfers, such as withdrawals or transfers made in person at the bank, by mail, or by using an ATM, do not count toward the six-per-month limit and do not affect the account’s status as a savings account. Also, a withdrawal

request by telephone does not count toward the limit, provided that the withdrawal is disbursed via check mailed to the depositor.

Examiners should be particularly wary of a bank's practices for handling telephone transfers. As noted, an unlimited number of telephone-initiated withdrawals are allowed so long as a check for the withdrawn funds is mailed to the depositor. Otherwise, the limit is six telephone transfers per month. The limit applies to telephonic transfers to move savings deposit funds to another type of deposit account and to make payments to third parties.

The limit on telephone transfers applies to both business and personal accounts, but banks should handle accounts that exceed the limit differently. Generally, if a savings deposit account exceeds, or is authorized to exceed, the "convenient" transfer limit, the bank should take away the transfer and draft capabilities of the account or close the account and place the funds in another account that the depositor is eligible to maintain. If the depositor is a natural person, the funds may be placed in a NOW account. If the depositor is not a natural person, the bank may be required to reclassify the account as a demand account, as businesses are not allowed to hold NOW accounts.

Savings deposit accounts have the following characteristics:

- Have no set maturity
- Bank must reserve the right to require at least seven days' notice of intent to withdraw funds (in practice, this right is rarely, if ever, exercised)
- May be interest-bearing
- Allow no more than six transfers or withdrawals per calendar month or statement cycle of at least four weeks for the purpose of transferring funds to another of the depositor's accounts at the same institution or making third-party payments by means of preauthorized, automatic, or telephonic transfers
- Allow no more than three of the six transfers to be made by check, draft, debit card, or similar order made by the depositor and payable to third parties
- Allow unlimited withdrawals by mail, messenger, ATM, in person, or by telephone (via check mailed to the depositor)
- Have no eligibility requirements
- May be reclassified as demand deposit accounts if held by a non-natural person and the withdrawal or transfer limit is exceeded
- May be reclassified as NOW accounts if held by a natural person and the withdrawal or transfer limit is exceeded

- Include money market deposit accounts (MMDAs)

### *Money Market Deposit Accounts*

Before the mid-1980s, money market deposit accounts (MMDAs) had characteristics that distinguished them from ordinary savings deposit accounts. Now, however, they have the same characteristics as savings deposit accounts and are subject to the same transfer and withdrawal limits.

## Highlights of Regulations Q and D that Affect Consumers

### Seven-Day Notice Period

Banks must reserve the right to require at least seven days' notice of a customer's intent to withdraw funds from savings accounts, NOW accounts, and ATS accounts. Banks have the option of enforcing this notice requirement, and in practice it is rarely, if ever, enforced.

If all or a portion of the funds in a time deposit account are withdrawn within six days of the date of deposit or of the most recent partial withdrawal, the account must be subject to an early withdrawal penalty. This penalty, which is the minimum penalty that may be imposed, is the loss of seven days' simple interest on the amount withdrawn.

If a bank allows customers to make partial withdrawals from time deposit accounts, the bank must impose the early withdrawal penalty on amounts withdrawn. For example, suppose a customer deposits \$1,000 into a new time deposit on the 1st of the month, withdraws \$100 on the 4th, and another \$100 on the 9th. The customer would be subject to an early withdrawal penalty for the first \$100 withdrawal in the amount of seven days' simple interest on \$100, and another early withdrawal penalty for the second \$100 withdrawal in the amount of seven days' simple interest on \$100 because the second withdrawal occurred within six days of the first withdrawal. If the bank does not impose the second early withdrawal penalty, the account ceases to be a time deposit account and should be reclassified as either a savings account (provided the account meets the characteristics of a savings account) or a transaction account.

### Interest-Period Extension

"Time deposits," as defined in Regulation D, include "time deposits that have matured or time deposits upon which the contractual required notice of withdrawal was given and the notice period has expired and which have not been renewed. . . ." Nonetheless, banks are permitted,

under Regulation Q, to continue to pay interest on a matured time deposit for up to ten days after its maturity under certain conditions. First, interest may be paid during such a period if the deposit account agreement specifies that interest will continue to be paid if the funds are withdrawn within ten days after the maturity date. Second, interest may be paid during the time between maturity and renewal of the time deposit account

(either automatically or by action of the depositor) if the renewal occurs within ten days or less of the maturity date. Otherwise, if the contract is not automatically renewable (or is not renewed) within ten days of the date of maturity and the bank continues to pay interest on the account during that period, the bank would be considered to be paying interest on a demand deposit.



# Regulation CC

## Availability of Funds and Collection of Checks

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### Background

Regulation CC (12 CFR 229) implements two laws—the Expedited Funds Availability Act (EFA Act), which was enacted in August 1987 and became effective in September 1988, and the Check Clearing for the 21st Century Act (Check 21), which was enacted in October 2003 and became effective on October 28, 2004. The regulation sets forth the requirements 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. It also establishes rules designed to speed the collection and return of unpaid checks and describes requirements that affect banks that create or receive substitute checks, including requirements related to consumer disclosures and expedited recredit procedures.

Regulation CC contains four subparts. The first three implement the EFA Act, and the fourth implements Check 21. Specifically,

- Subpart A—Defines terms and provides for administrative enforcement
- Subpart B—Specifies availability schedules, or time frames within which banks must make funds available for withdrawal; also includes rules concerning exceptions to the schedules, disclosure of funds availability policies, and payment of interest
- Subpart C—Sets forth rules concerning the expeditious return of checks, the responsibilities of paying and returning banks, authorization of direct returns, notification of nonpayment of large-dollar returns by the paying bank, check-endorsement standards, and other related changes to the check-collection system
- Subpart D—Contains provisions concerning the requirements a substitute check must meet to be the legal equivalent of an original check; bank duties, warranties, and indemnities associated with substitute checks; expedited recredit procedures for consumers and banks; and consumer disclosures regarding substitute checks

The appendixes to the regulation provide additional information:

- Appendixes A and B—Routing number guide
- Appendix C—Model forms and clauses that banks may use to meet their disclosure responsibilities under the regulation

- Appendix D—Standards for check endorsement by banks

### SUBPART A—GENERAL

#### Definitions—Section 229.2

##### Bank

The term *bank* refers to FDIC-insured banks, mutual savings banks, savings banks, and savings associations; federally insured credit unions; non-federally insured banks, credit unions, and thrift institutions; agencies and branches of foreign banks; and Federal Home Loan Bank (FHLB) members.

For purposes of subparts C and D, “bank” also includes any person engaged in the business of banking, Federal Reserve Banks, FHLBs, and state and local governments to the extent that the government unit pays checks.

For purposes of subpart D only, “bank” also refers to the U.S. Treasury and the U.S. Postal Service (USPS) to the extent that they act as payors.

- The term *paying bank* applies to any bank at which or through which a check is payable and to which it is sent for payment or collection. For purposes of subpart D, “paying bank” also includes the U.S. Treasury and the USPS. The term also includes Federal Reserve Banks, FHLBs, state and local governments, and, if the check is not payable by a bank, the bank through which a check is payable.
- A *reconverting bank* is the bank that creates a substitute check or is the first bank to transfer or present a substitute check to another party.

##### Check

The term *check* includes both original checks and substitute checks.<sup>1</sup>

- An *original check* is the first paper check issued with respect to a particular payment transaction.
- A *substitute check* is a paper reproduction of an original check that
  - Contains an image of the front and back of the original check,
  - Bears a MICR line containing all of the

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1. The term “check” does not include checks drawn in a foreign currency or checks drawn on a bank located outside the United States.



information encoded on the original check's MICR line, except as provided in the industry standard for substitute checks,<sup>2</sup>

- Conforms in dimension, paper stock, and otherwise with industry standards for substitute checks, and
- Is suitable for automated processing in the same manner as the original check.

A substitute check for which a bank has provided the warranties described in section 229.52 is the legal equivalent of an original check if the substitute check accurately represents all of the information on the front and back of the original check and bears the legend "This is a legal copy of your check. You can use it the same way you would use the original check."

- A *copy* of an original check is any paper reproduction of an original check, including a paper printout of an electronic image, a photocopy, or a substitute check. A *sufficient copy* is a copy of an original check that accurately represents all of the information on the front and back of the check at the time of truncation or is otherwise sufficient to establish the validity of a claim.
- *Truncate* means to remove an original check from the forward collection or return process and replace it with a substitute check or, by agreement, information relating to the original check. The truncating bank may or may not choose to provide subsequent delivery of the original check.
- A *local* check is a check deposited in a depository bank that is located in the same Federal Reserve check-processing region as the paying bank. A *nonlocal* check is a check deposited in a check-processing region different from that of the paying bank.

## Account

For purposes of subparts B and C, an *account* is a "deposit" (as defined in the Board's Regulation D, in 12 CFR 204.2(a)(1)(i)) that is a "transaction account" (as defined in 12 CFR 204.2(e)). "Account" encompasses consumer and corporate accounts and includes accounts from which the account holder is permitted to make transfers or withdrawals by any of the following:

- Negotiable instrument
- Payment order of withdrawal
- Telephone transfer
- Electronic payment

For purposes of subpart B, "account" does not include accounts for which the account holder is a bank, a foreign bank, or the Treasury of the United States.

For purposes of subpart D, "account" means any deposit at a bank, including a demand deposit or other transaction account and a savings deposit or other time deposit. Many deposits that are not accounts for purposes of the other subparts of Regulation CC, such as savings deposits, are accounts for purposes of subpart D.

## Consumers and Customers

- A *consumer* is a natural person who draws a check on a consumer account or cashes or deposits a returned check against a consumer account.
- A *consumer account* is an account used primarily for personal, family, or household purposes.
- A *customer* is a person who has an account with a bank.

## Business and Banking Days

- A *business day* is any day except Saturday, Sunday, and a legal holiday (standard Federal Reserve holiday schedule).
- A *banking day* is a business day on which a bank is open for substantially all its banking activities.

Even though a bank may be open for regular business on a Saturday, that day is not considered a banking day for purposes of Regulation CC because Saturday is never a "business day" under the regulation. The fact that one branch is open to the public for substantially all its banking activities does not necessarily mean that that day is a banking day for the other branches of the bank.

## Administrative Enforcement— Section 229.3

Regulation CC is to be enforced for banks through section 8 of the Federal Deposit Insurance Act (12 USC 1818) and through the Federal Credit Union Act (12 USC 1751 et seq.). In addition, a supervisory agency may enforce compliance through any other authority conferred on it by law. The Federal Reserve Board is responsible for enforcing the requirements of Regulation CC for depository institutions that are not specifically the responsibility of another government agency.

2. "MICR (magnetic ink character recognition) line" refers to the numbers—including routing number, account number, check number, and check amount—that are printed across the bottom of a check in magnetic ink. The industry standard for substitute checks is American National Standard Specifications for an Image Replacement Document-IRD, X9.100-140. ANS X9.100-140 specifies ways in which the content of a substitute check's MICR line may vary from the content of the original check's MICR line. ANS X9.100-140 also specifies circumstances in which a substitute check MICR line need not be printed in magnetic ink.

## SUBPART B—AVAILABILITY OF FUNDS AND DISCLOSURE OF FUNDS AVAILABILITY POLICIES

### Next-Day Availability—Section 229.10

Rules governing next-day availability of funds are set forth in section 229.10.

#### General Rules (§§ 229.10(a)–229.10(c))

Cash, electronic payments, and certain check deposits must generally be made available for withdrawal the business day after the banking day on which they were received. Among the covered check deposits are cashier's, certified, and teller's checks; government checks (including U.S. Treasury checks, U.S. Postal Service money orders, state and local government checks, and checks drawn on a Federal Reserve Bank or a Federal Home Loan Bank); and certain *on-us* checks (checks drawn on the same bank, or a branch thereof).

Generally, to qualify for next-day availability, the deposit must be both

- Made at a staffed teller station and
- Deposited into an account held by the payee of the check.

Exceptions are U.S. Treasury checks and *on-us* checks, which must receive next-day availability even if the deposit is not made at a staffed teller station. Cash and other next-day check deposits (such as Postal Service money orders, cashier's checks, certified checks, checks drawn on a state or local government, and checks drawn on a Reserve Bank or a Federal Home Loan Bank) that are not made at a staffed teller station must be available for withdrawal on the second business day after the day of deposit. (§§ 229.10(a)(2) and 229.10(c)(2))

#### Additional Rules

A few additional rules also apply:

- State and local government checks—For state and local government checks to receive next-day availability, the depository bank must be located in the same state as the governmental unit issuing the check. (§§ 229.10(c)(1)(iv) and 229.10(c)(1)(v))
- Special deposit slips or envelopes—For deposits of state and local government checks, as well as deposits of cashier's, certified, and teller's checks, the depository bank may require the use of special deposit slips or envelopes. If the depository bank requires the use of special

deposit slips or envelopes, it must either provide the slips or tell customers how they can be obtained. (§ 229.10(c)(3))

- On-us checks—For an on-us check to receive next-day availability, it must be drawn on the same branch or another branch of the bank where it is deposited. In addition, both branches must be located in the same state or check-processing region. (§ 229.10(c)(1)(vi))
- \$100 rule—Under a special rule for check deposits not subject to next-day availability, the depository bank must provide next-day availability for withdrawal of the lesser of \$100 or the aggregate amount deposited to all accounts, including individual and joint accounts, held by the same customer on any one banking day. The \$100 rule does not apply to deposits received at nonproprietary ATMs. (§ 229.10(c)(1)(vii))

### Availability Schedule—Section 229.12

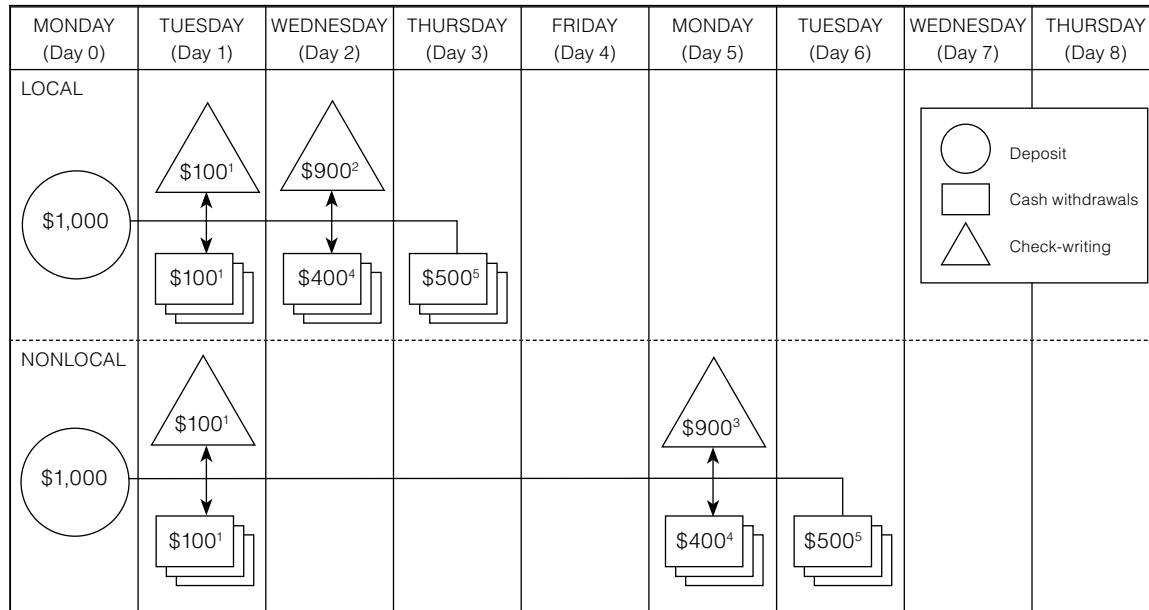
#### General Rules (§§ 229.12(a)–229.12(c) and 229.12(f))

Under the permanent availability schedule, which became effective in September 1990 (figures 1 and 2), local check deposits must be made available no later than the second business day following the day on which the funds were deposited. Deposits of nonlocal checks must be made available no later than the fifth business day following the banking day of deposit. Funds deposited at nonproprietary ATMs, including cash and all checks, must be made available no later than the fifth business day following the banking day on which they were deposited.

Checks that would normally receive next-day availability are treated as local or nonlocal check deposits if they do not meet all the criteria for next-day availability under section 229.10(c). (As noted in the preceding section, certain checks generally deposited at a staffed teller station and into an account held by the payee of the check receive next-day availability. However, state and local government checks and certain on-us checks are subject to additional rules.)

U.S. Treasury checks and Postal Service money orders that do not meet all the requirements for next-day or second-day availability outlined in section 229.10(c) receive funds availability as if they were *local* checks. Cashier's, certified, teller's, and state and local government checks and checks drawn on a Federal Reserve Bank or Federal Home Loan Bank that do not meet all the requirements in section 229.10(c) receive funds availability as either local or nonlocal checks according to the location of the bank on which they are drawn.

**Figure 1**  
**Availability of Different Types of Checks Deposited on the Same Day**



1. The first \$100 of a day's deposit must be made available for either cash withdrawal or check-writing purposes at the start of the next business day. (§ 229.10(c)(1)(vii))

2. Local checks must be made available for check-writing purposes by the second business day following deposit. (§ 229.12(b))

3. Nonlocal checks must be made available for check-writing purposes by the fifth business day following deposit. (§ 229.12(c))

4. \$400 of the deposit must be made available for cash withdrawal no later than 5:00 p.m. on the day specified in the schedule. This is in addition to the \$100 that must be made available on the business day following deposit. (§ 229.12(d))

5. The remainder of the deposit must be made available for cash withdrawal at the start of business the following day. (§ 229.12(d))

**Special Rules for Cash Withdrawals (§ 229.12(d))**

Special rules apply to cash withdrawals from local and nonlocal check deposits. While the depository bank is allowed to extend the availability schedule for cash or similar withdrawals by one day, the customer must still be allowed to withdraw the first \$100 of any check deposit not subject to next-day availability on the business day following the day of deposit. In addition to the first \$100, a customer must also be allowed to withdraw \$400 of the deposited funds (or the maximum amount that may be withdrawn from an ATM, but not more than \$400) no later than 5:00 p.m. on the day the funds become available for check withdrawals. The remainder of the deposited funds would be available for cash withdrawal on the following business day.

the availability schedules for local and nonlocal checks by one day. The exception does not apply to checks drawn on banks in these states or territories and deposited in banks located in the continental United States.

**Exceptions to the Availability Schedule—Section 229.13**

The regulation provides for exceptions that allow banks to exceed the maximum hold periods specified in the availability schedule. The exceptions are considered "safeguards" because they offer institutions a means of reducing risk based on the size of the deposit, the depositor's past performance, the absence of a record on the depositor's past performance, or a belief that the deposit may not be collectible.

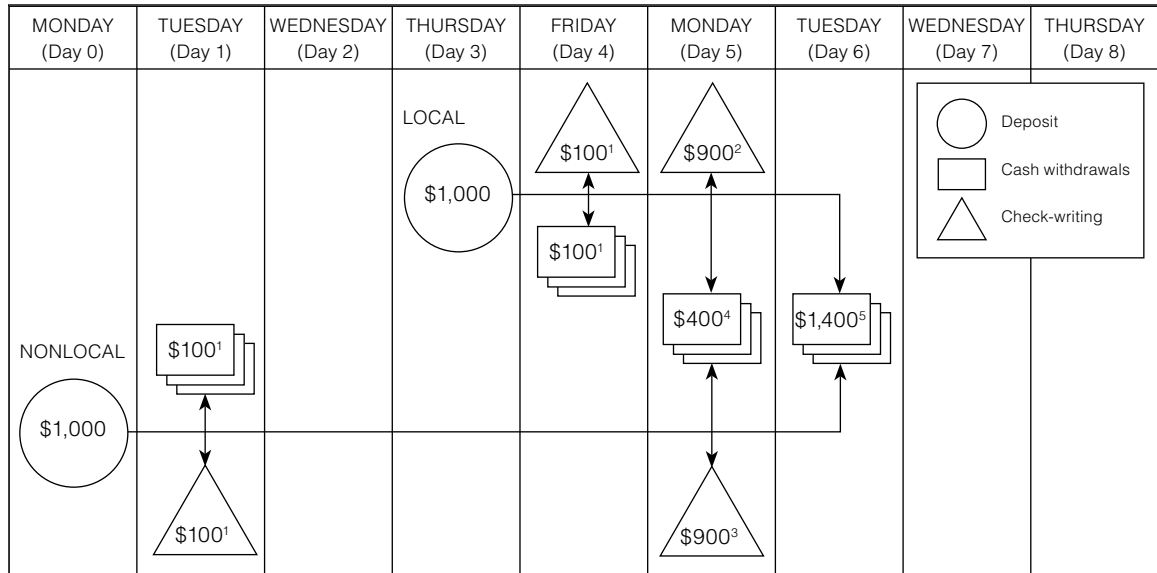
**Extension of the Schedule for Certain Deposits (§ 229.12(e))**

Banks in Alaska, Hawaii, Puerto Rico, and the Virgin Islands that receive checks drawn on or payable through banks located in another state may extend

**Categories of Exception (§§ 229.13(a)–229.13(f))**

The regulation provides for exceptions in six situations:

**Figure 2**  
**Availability of Different Types of Checks Deposited on Separate Days**



1. The first \$100 of a day's deposit must be made available for either cash withdrawal or check-writing purposes at the start of the next business day. (§ 229.10(c)(1)(vii))

2. Local checks must be made available for check-writing purposes by the second business day following deposit. (§ 229.12(b))

3. Nonlocal checks must be made available for check-writing purposes by the fifth business day following deposit. (§ 229.12(c))

4. \$400 of the deposit must be made available for cash withdrawal no later than 5:00 p.m. on the day specified in the schedule. This applies to the aggregate amount of deposits that must be made available on a specified day, and is in addition to the \$100 that must be made available on the business day following deposit. (§ 229.12(d))

5. The remainder of the deposit must be made available for cash withdrawal at the start of business the following day. (§ 229.12(d))

- New accounts
- Deposits in excess of \$5,000 on any one day
- Checks that have been returned unpaid and are being redeposited
- Deposits to accounts that have been repeatedly overdrawn
- Cases in which the bank has reasonable cause to believe the check being deposited is uncollectible
- Emergency conditions

Although banks may exceed the time frames for availability in these situations, the exceptions generally may not be invoked if the deposit would ordinarily receive next-day availability.

**New Accounts (§ 229.13(a))**

An account is considered a "new" account, under section 229.13(a), for the first thirty calendar days it is open, beginning on the date the account is established. An account is not considered "new" if "each customer on the account has had, within thirty calendar days before the account is estab-

lished, another account at the . . . bank for at least thirty calendar days."

The new-account exception does not cover all deposits made to the account. New accounts are exempted from the availability schedules for deposits of local and nonlocal checks, but next-day availability is required for deposits of cash and for electronic payments. Also, the first \$5,000 of a day's aggregate deposits of government checks (including federal, state, and local governments), cashier's, certified, teller's, depository, or traveler's checks must be given next-day availability. The amount in excess of \$5,000 must be made available no later than the ninth business day following the day of deposit.

To qualify for next-day availability, deposits into a new account generally must be made in person to an employee of the depository bank. If the deposits are not made in person to an employee of the depository bank—for instance, if they are made at an ATM—availability may be provided on the second business day after the day of deposit. Treasury check deposits, however, must be given next-day availability regardless of whether they are

made at staffed teller stations or ATMs. Banks are not required to make the first \$100 of a day's deposits of local and nonlocal checks, or the funds from on-us checks, available on the next business day.

#### *Large Deposits (Deposits over \$5,000)* (§ 229.13(b))

A depository bank may extend hold schedules when deposits other than cash or electronic payments exceed \$5,000 on any one day. A hold may be applied to the amount in excess of \$5,000. To apply the rule, the depository bank may aggregate deposits made to multiple accounts held by the same customer, even if the customer is not the sole owner of the accounts.

#### *Redeposited Checks (§ 229.13(c))*

A depository bank may delay making the funds from a check available if the check had previously been deposited and returned unpaid. The exception does not apply to checks that were previously returned unpaid because of a missing endorsement or because the check was postdated when presented.

#### *Repeated Overdrafts (§ 229.13(d))*

If a customer's account, or accounts, have been repeatedly overdrawn during the preceding six months, the bank may delay making the funds from a check available. A customer's account may be considered repeatedly overdrawn in two ways. First, the exception may be applied if the account was overdrawn, or would have been overdrawn had check or other charges been paid, for six or more banking days during the preceding six months.

Second, the exception may be applied to customers who incurred overdrafts on two banking days within the preceding six-month period if the negative balance in the account(s) at that time was \$5,000 or more. The exception may also apply if the account would have been overdrawn by \$5,000 or more had the check or other charges been paid.

#### *Reasonable Cause to Doubt Collectibility* (§ 229.13(e))

This exception may be applied to all types of checks. To trigger the exception, the depository institution must have reasonable cause to believe that the check is not collectible and must disclose the basis for the extended hold to the customer. The basis for reasonable cause may include, for example, communication with the paying bank indicating that

- A stop-payment order has been placed on the check
- There are insufficient funds in the drawer's account to cover the check
- The check will be returned unpaid

The reasonable-cause exception may also be invoked in cases in which

- The check was deposited six months after the date of the check (stale date)
- The check was postdated (future date)
- The depository bank believes that the depositor may be engaged in check kiting
- The depository bank has other confidential information, such as the insolvency or pending insolvency of the customer

The reasonable-cause exception may not be invoked because of either

- The race or national origin of the depositor or
- The fact that the paying bank is located in a rural area and the depository bank will not have time to learn of nonpayment of the check before the funds have to be made available under the availability schedules in place.

If the depository bank intends to use this exception, it must notify the customer, in writing, at the time of deposit. If the deposit is not made in person or the decision to place the hold is based on facts that become known to the bank at a later date, the bank must mail the notice by the business day after the day the deposit is made or the facts become known. The notice must indicate that availability is being delayed and must include the reason the bank believes the funds are uncollectible. If a hold is placed on the basis of confidential information, as when check kiting is suspected, the bank need only disclose to the customer that the hold is based on confidential information indicating that the check may not be paid.

If the depository bank asserts that the hold was based on confidential information, it must note the reason on the notice it retains as a record of compliance. The bank must maintain a record of each exception notice, including documents and a brief description of the facts supporting the reasonable-cause exception, for two years.

#### *Overdraft and returned-check fees* (§ 229.13(e)(2))

If a depository bank invokes the reasonable-cause exception and does not inform the customer in writing at the time of the deposit, it may not charge the customer any overdraft or returned-check fees resulting from the hold if

- The deposited check is paid by the paying bank and
- The overdraft would not have occurred or the check would not have been returned had the depository bank not imposed the reasonable-cause hold.

However, the depository bank may assess overdraft or returned-check fees if the exception hold notice states that the customer may be entitled to a refund of any overdraft or returned-check fees imposed and describes how the customer can obtain the refund. The bank must then refund the fees upon request.

#### *Emergency Conditions (§ 229.13(f))*

Banks may suspend the availability schedule under the following emergency conditions:

- An interruption of communications or computer or other equipment facilities
- Suspension of payments by another depository institution
- War
- Any emergency condition beyond the control of the depository bank

#### *Notices of Exception (§ 229.13(g))*

Whenever a bank invokes one of the exceptions to the availability schedules (except the new-account exception), it must notify the customer in writing. The bank may send a notice that complies solely with section 229.13(g)(1) (the “general exception notice”) or one of the two alternative notices described below.

##### *General Exception Notice (§ 229.13(g)(1))*

The general notice of exception must include the following:

- The customer’s account number
- The date of the deposit
- The amount of the deposit that will be delayed
- The reason the exception was invoked
- The day the funds will be available for withdrawal (unless unknown, as in an emergency situation)

If the deposit is made at a staffed facility, the notice may be given to the person making the deposit, regardless of whether that person is the customer who holds the account. If the deposit is not made at a staffed facility, the exception notice may be mailed to the customer no later than the business day following the banking day of deposit. If the depository bank discovers a reason to delay the funds subsequent to the time the notice should

have been given, the bank must notify the customer about the hold as soon as possible, but no later than the business day after the facts become known. Certain exception holds due to emergency conditions do not require notification of customers. For example, if the deposited funds that were subject to a hold during an emergency become available for withdrawal before the time the notice must be sent, the depository bank need not send a notice.

##### *One-Time Exception Notice for Nonconsumer Accounts (§ 229.13(g)(2))*

If most of the check deposits into a particular nonconsumer account qualify for either the large-deposit exception or the redeposited-check exception, the bank may send a one-time notice rather than a notice complying with section 229.13(g)(1) each time the exception is invoked. The one-time notice must be sent either the first time the exception is invoked or before that time. It must state both

- The reason the exception may be invoked and
- The time period when the funds will generally be made available.

##### *Exception Notice for Repeated Overdrafts (§ 229.13(g)(3))*

If most of the check deposits into a particular account qualify for the repeated-overdraft exception, the bank may send an exception notice that covers a specified period of time rather than a notice complying with section 229.13(g)(1) each time the exception is invoked. The “specified period” notice must be sent when the overdraft exception is first invoked. It must state all of the following:

- The customer’s account number
- The fact that access to the funds is being delayed because the repeated-overdraft exception is being invoked
- The time period during which the exception will apply
- The time period within which the funds generally will be available for withdrawal

#### *Availability of Deposits Subject to Exceptions (§ 229.13(h))*

For deposits subject to exceptions to the availability schedules, other than deposits into new accounts, the depository bank is permitted to delay availability for a *reasonable* time beyond the schedule. Generally, a reasonable period is considered to be no more than one business day for

on-us checks, five business days for local checks, and six business days for nonlocal checks. If a depository bank extends its availability beyond these time frames, it must be able to prove that the extended delay is reasonable.

## Payment of Interest—Section 229.14

### General Rule (§ 229.14(a))

A depository bank must begin accruing interest on interest-bearing accounts no later than the business day on which it receives provisional credit for the deposited funds. A depository bank typically receives credit on checks within one or two days following deposit. It receives credit on cash deposits, electronic payments, and checks that are drawn on itself on the day the cash, check, or electronic payment is received. And if a nonproprietary ATM is involved, it usually receives credit on the day the bank that operates the ATM credits the depository bank for the amount of deposit.

A depository bank may rely on the availability schedule of its Federal Reserve Bank, Federal Home Loan Bank, or correspondent bank when determining when the depository bank receives credit (section 229.14(a)(1)). If availability is delayed beyond the time specified in that schedule, a bank may charge back to the account any interest erroneously paid or accrued on the basis of that schedule.

A depository bank may accrue interest on checks deposited to all of its interest-bearing accounts based on an average of when the bank receives credit for all checks sent for payment or collection (section 229.14(a)(2)). For example, if a bank receives credit on 20 percent of the funds deposited by check on the business day of deposit (for example, via on-us checks), 70 percent on the business day following deposit, and 10 percent on the second business day following deposit, the bank may apply these percentages to determine the day on which interest must begin to accrue for check deposits into all interest-bearing accounts, regardless of when the bank received credit for deposits into any particular account. Consequently, a bank may begin accruing interest uniformly across all interest-bearing accounts rather than having to track the type of check deposited to each account.

Nothing in the general rule limits a depository bank policy that provides that interest may accrue only on balances that exceed a specified amount or on the minimum balance maintained in the account during a given period. However, the balance must be determined according to the date the bank receives credit for the funds. Nor is there

a limit on a policy that provides that interest may accrue sooner than required by the regulation.

Money market deposit accounts, savings deposit accounts, and time deposit accounts are not subject to the general rule concerning the timing of interest payment. However, for simplicity of operation, a bank may accrue interest on such deposits in the same manner that it accrues interest on transaction accounts.

### Exemption for Certain Credit Unions (§ 229.14(b))

Credit unions that do not begin to accrue interest or dividends on their members' accounts until a date later than the day the credit union receives credit for those deposits, including cash deposits, are exempt from the general rule for payment of interest (section 229.14(a)) as long as they provide notice of their interest-accrual policies in accordance with section 229.16(d).

### Exception for Checks Returned Unpaid (§ 229.14(c))

Banks are not required to pay interest on funds deposited in an interest-bearing account by a check that has been returned unpaid, regardless of the reason for return.

## General Disclosure Requirements—Section 229.15

### Form of Disclosures (§ 229.15(a))

A bank must disclose its funds availability policy to its customers. The disclosures must be clear and conspicuous and must be in writing. Disclosures other than those posted at locations where employees accept consumer deposits, at ATMs, or on preprinted deposit slips must be in a form that customers can keep. They must be grouped and must not contain information unrelated to the requirements of Regulation CC. If other account terms are included in the same document, disclosures related to the regulation should be highlighted, for example, by having a separate heading.

### Uniform Reference to Day of Availability (§ 229.15(b))

A bank must refer to the day on which funds will be available for withdrawal in a uniform manner in all its disclosures. The statement should describe funds as being available for withdrawal on “the \_\_\_\_\_ business day after” the day of deposit. The first business day is the business day following the banking day the deposit was received, and the last

business day is the day on which the funds are made available.

### Multiple Accounts and Multiple Account Holders (§ 229.15(c))

A bank is not required to give multiple disclosures to customers who have more than one account if the accounts are subject to the same availability policies. Nor is a bank required to give separate disclosures to joint account holders; a single disclosure to one of the holders of the joint account is sufficient.

### Dormant or Inactive Accounts (§ 229.15(d))

A bank is not required to give disclosures to customers who have dormant or inactive accounts.

## Specific Availability Policy Disclosure—Section 229.16

The disclosure describing its funds availability policy that a bank must provide to its customers must reflect the policy followed by the institution in most cases. If the institution wishes to reserve its right to impose longer delays on a case-by-case basis or by invoking one of the exceptions specified in section 229.13, its policy regarding these situations must be reflected in the disclosure.

### Content of Specific Availability Policy Disclosure (§ 229.16(b))

A bank's specific availability policy disclosure must include, as applicable, the following:

- A summary of the bank's availability policy
- A description of the categories of deposits or checks used by the bank when it delays availability, such as local or nonlocal checks; how to determine the category to which a particular deposit or check (such as a payable-through draft) belongs; and when each category will be available for withdrawal (including a description of the bank's business days and when a deposit is considered received)
- A description of any of the exceptions specified in section 229.13 that may be invoked by the bank, including the time at which the deposited funds generally will become available for withdrawal and a statement that the bank will notify the customer if the bank invokes one of the exceptions
- A description of any case-by-case policy of delaying availability that may result in deposited funds being available for withdrawal later than

the time periods stated in the bank's availability policy (specific requirements are laid out in section 229.16(c)(1))

### Longer Delays on a Case-by-Case Basis (§ 229.16(c))

A bank that has a policy of making deposited funds available for withdrawal sooner than required may extend the time when funds are available up to the time periods allowed under the regulation on a case-by-case basis. However, the bank must include the following in its specific policy disclosure:

- A statement that the time when deposited funds are available for withdrawal may be extended in some cases, and a statement of the latest time deposited funds will be available for withdrawal
- A statement that the bank will notify the customer if funds deposited in the customer's account will not be available for withdrawal until after the time periods stated in its availability policy
- A statement that customers should ask if they need to know when a particular deposit will be available for withdrawal

When a depository bank extends the time that funds will be available for withdrawal on a case-by-case basis, it must provide the depositor with a written notice. The notice must include all of the following information:

- The customer's account number
- The date and amount of the deposit
- The amount of the deposit that is being delayed
- The day the funds will be available for withdrawal

The notice must be provided at the time of the deposit, unless the deposit was not made in person to an employee of the depository bank or the decision to delay availability was made after the time of the deposit. If notice is not given at the time of the deposit, the depository bank must mail or deliver the notice to the customer no later than the first business day following the banking day the deposit was made.

A depository bank that extends the time when funds will be available for withdrawal on a case-by-case basis and does not furnish the depositor with written notice at the time of deposit may not assess any fees for any subsequent overdrafts (including use of a line of credit) or return of checks or other debits to the account if

- The overdraft or return of the check or other debit would not have occurred except for the fact that the deposited funds were delayed under section 229.16(c)(1) of the regulation and



- The deposited check was paid by the paying bank.

However, the depository bank may assess an overdraft or returned-check fee if it includes a notice concerning overdraft and returned-check fees with the disclosure required in section 229.16(c)(2) and, when required, refunds any such fees upon the request of the customer. The overdraft and returned-check notice must state that the customer may be entitled to a refund of overdraft or returned-check fees that are assessed if the check subject to the delay is paid, and also must state how to obtain a refund.

#### Credit Union Notice of Interest-Payment Policy (§ 229.16(d))

If a credit union begins to accrue interest or dividends on all deposits made into an interest-bearing account, including cash deposits, at a later time than the day specified in section 229.14(a), the institution's specific policy disclosures must explain when interest or dividends on deposited funds will begin to accrue.

#### Initial Disclosures—Section 229.17

A bank must provide potential customers with the disclosures described in section 229.16 before an account is opened.

#### Additional Disclosure Requirements—Section 229.18

##### Deposit Slips (§ 229.18(a))

All preprinted deposit slips given to customers must include a notice that deposits may not be available for immediate withdrawal.

##### Locations Where Employees Accept Consumer Deposits (§ 229.18(b))

A bank must post, at a conspicuous place at each location where its employees receive deposits to consumer accounts, a notice that sets forth the time periods applicable to the availability of funds deposited.

##### Automated Teller Machines (§ 229.18(c))

At each of its ATM locations, a depository bank must post or provide a notice that funds deposited in the ATM may not be available for immediate withdrawal. A depository bank that operates an off-premises ATM from which deposits are removed not more than two times each week, as described in section 229.19(a)(4), must disclose at or on the

ATM the days on which deposits made at the ATM will be considered received.

##### Upon Request (§ 229.18(d))

A bank must provide a copy of its specific availability policy disclosure (described in section 229.16) to any person who requests it.

##### Changes in Policy (§ 229.18(e))

Thirty days before implementing a change in its availability policy, a bank must send notification of the change to all account holders adversely affected by the change. Changes that result in faster availability may be disclosed no later than thirty days after implementation.

#### Miscellaneous Provisions—Section 229.19

##### When Funds Are Considered Deposited (§ 229.19(a))

For purposes of subpart B of Regulation CC (sections 229.10–229.21), the time at which funds must be made available for withdrawal is measured from the day the funds are considered deposited (or “received” by the bank). When funds are considered officially deposited differs according to where, how, and when they are deposited:

- Funds deposited at a staffed teller station or a staffed ATM—Considered deposited when received by the teller or placed in the ATM.
- Funds mailed to the depository bank—Considered deposited on the banking day they are received by the depository bank; in this case, funds are considered “received” at the time the mail is delivered to the bank, even if it is initially delivered to a mail room rather than the check-processing area.
- Funds deposited at a night depository—Considered deposited on the banking day the funds are removed from the night depository and are accessible to the depository bank for processing. For example, some businesses deposit their funds in a locked bag at the night depository late in the evening and return to the bank the following day to open the bag; others have an agreement with the bank that the deposit bag must be opened under the dual control of the bank and the depositor. In both cases, the funds are considered deposited when the customer returns to the bank and opens the deposit bag.
- Funds deposited through a lock box arrangement—Considered deposited on the day the funds are removed from the lock box and are

accessible to the depository bank for processing. A *lock box* is a post office box that is typically used by a corporation for the collection of bill payments or other check receipts.

- Funds deposited at off-premises ATMs that are not serviced more than twice a week—Considered deposited on the day they are removed from the ATM. This special provision is geared toward banks whose practice is to service remote ATMs infrequently. A depository bank that uses this provision must post a notice at the ATM informing depositors that funds deposited at the ATM may not be considered received on the date of deposit.
- Funds deposited on a day the depository bank is closed or after the bank's cutoff hour—May be considered deposited on the next banking day.

### Cutoff Hours

Generally, a bank may establish a cutoff hour of 2:00 p.m. or later for receipt of deposits at its main office or branch offices and a cutoff hour of 12:00 noon or later for deposits made at ATMs, lock boxes, night depositories, or other off-premises facilities. (As specified in the commentary to section 229.19(a), the 12:00 noon cutoff time relates to the local time at the branch or other location of the depository bank where the account is maintained or the local time at the ATM or off-premises facility.)

Different cutoff hours may be established for different types of deposits—for example, a 2:00 p.m. cutoff for receipt of check deposits and a later time for receipt of wire transfers is permissible. Location can also play a role in the establishment of cutoff hours; for example, different cutoff hours may be established for ATM deposits and over-the-counter deposits, or for different teller stations at the same branch. With the exception of the 12:00 noon cutoff hour for deposits at ATMs and off-premises facilities, the cutoff hour for receipt of deposits may not be earlier than 2:00 p.m.

### Hour of Funds Availability (§ 229.19(b))

Generally, funds must be available for withdrawal by 9:00 a.m. or the time a depository bank's teller facilities, including ATMs, are available for customer account withdrawals, whichever is later. (Under certain circumstances, there is a special exception for cash withdrawals—see section 229.12(d).) Thus, if a bank has no ATMs and its branch facilities are available for customer transactions beginning at 10:00 a.m., funds must be available for withdrawal by 10:00 a.m. If a bank has 24-hour ATM service, funds must be available for ATM withdrawals by 9:00 a.m.

The start of business is determined by the local time at the branch or depository bank holding the account. For example, if funds in an account at a West Coast bank are first made available at the start of business on a given day and a customer attempts to withdraw the funds at an East Coast ATM, the depository bank is not required to make funds available until 9:00 a.m. West Coast time (12:00 noon East Coast time).

### Effects of the Regulation on Depository Bank Policies (§ 229.19(c))

Essentially, a depository bank is permitted to provide availability to its customers in a shorter time than that prescribed in the regulation. The bank may also adopt different funds availability policies for different segments of its customer base, so long as each policy meets the schedules in the regulation. For example, it may differentiate between its corporate and consumer customers, or may adopt different policies for its consumer customers based on whether a customer has an overdraft line of credit associated with his or her account.

The regulation does not affect a depository bank's right to accept or reject a check for deposit, to "charge back" the customer's account for the amount of a check based on the return of the check or receipt of a notice of nonpayment of the check, or to claim a refund for any credit provided to the customer.

Nothing in the regulation requires a depository bank to have its facilities open for customers to make withdrawals at specified times or on specific days. For example, even though the special cash withdrawal rule set forth in section 229.12(d) states that a bank must make up to \$400 available for cash withdrawals no later than 5:00 p.m. on specific business days, if a bank does not participate in an ATM system and does not have any teller windows open at or after 5:00 p.m., the bank need not join an ATM system or keep offices open. In this case, the bank complies with the rule if the funds that are required to be available for cash withdrawal at 5:00 p.m. on a particular day are available for withdrawal at the start of business on the following day. Similarly, if a depository bank is closed for customer transactions, including ATM transactions, on a day on which funds must be made available for withdrawal, the regulation does not require the bank to open.

If a bank has a policy of limiting cash withdrawals at ATMs to \$250 a day, the regulation does not require that the bank dispense \$400 of the proceeds of the customer's deposit that must be made available for cash withdrawal on that day.

Some small financial institutions do not keep cash on their premises and do not offer cash

withdrawal services to their customers. Others limit the amount of cash on their premises, for reasons related to bonding, and as a result reserve the right to limit the amount of cash a customer may withdraw on a given day or to require advance notice for large cash withdrawals. Nothing in the regulation is intended to prohibit these practices if they are applied uniformly and are based on security, operating, or bonding requirements and if the policy is not dependent on the length of time the funds have been in the customer's account, as long as the permissible hold has expired. However, the regulation does not authorize such policies if they are otherwise prohibited by statutory, regulatory, or common law.

### Calculated Availability for Nonconsumer Accounts (§ 229.19(d))

Under calculated availability, a specified percentage of funds from check deposits may be made available to the customer on the next business day, with the remaining percentage deferred until subsequent days. The determination of the percentage of deposited funds that will be made available each day is based on the customer's typical deposit mix as determined by a sample of the customer's deposits. Use of calculated availability is permitted only if, on average, the availability terms that result from the sample are equivalent to or more prompt than the requirements of the regulation.

### Holds on Other Funds (§ 229.19(e))

If a customer deposits a check, the bank may place a hold on any of the customer's funds to the extent that the funds held do not exceed the amount of the check deposited and if the total amount of funds held are made available for withdrawal within the times required in the regulation. For example, if a customer cashes a check (other than an on-us check) over-the-counter, the depository bank may place a hold on any of the customer's funds to the extent that the funds held do not exceed the amount of the check cashed.

### Employee Training and Compliance (§ 229.19(f))

The Expedited Funds Availability Act requires banks to inform each employee who performs duties subject to the act about its requirements. The act and Regulation CC also require banks to establish and maintain procedures designed to ensure and monitor employee compliance with the requirements.

### Effects of Mergers (§ 229.19(g))

Merged banks may be treated as separate banks for a period of up to one year after consummation of the merger transaction. However, a customer of any bank that is a party to the merger transaction and has an established account with the merging bank may not be treated as a new account holder under the new-account exception of section 229.13(a). A deposit in any branch of the merged bank is considered deposited in the bank for purposes of the availability schedules in accordance with section 220.19(a).

This rule affects the status of the combined entity in a number of areas, for example,

- When the resulting bank is a *participant* in a check clearinghouse association
- When an ATM is a *proprietary* ATM
- When a check is drawn on a branch of the depository bank

### Relation to State Law— Section 229.20

#### General Rule (§ 229.20(a))

If a state has a shorter hold for a certain category of checks than is provided for under federal law, the state requirement supersedes the federal provision. For example, most state laws base some hold periods on whether the check deposited is drawn on an in-state or out-of-state bank. If a state contains more than one check-processing region, the state's hold period for in-state checks may be shorter than the federal maximum hold period for nonlocal checks. Accordingly, the state schedule supersedes the federal schedule to the extent that it applies to in-state, nonlocal checks.

The Expedited Funds Availability Act also indicates that any state law providing availability in a shorter period of time than required by federal law is applicable to all federally insured institutions in that state, including federally chartered institutions. If a state law provides shorter availability only for deposits in accounts in certain categories of banks, such as commercial banks, the superseding state law continues to apply to only those categories of banks, rather than to all federally insured banks in the state.

#### Preemption of Inconsistent Law (§ 229.20(b))

Provisions of state laws that are inconsistent with federal law, other than those discussed in the preceding section ("General Rule"), are preempted. State laws requiring disclosure of availability policies for transaction accounts are preempted

by Regulation CC. Preemption does not require a determination by the Federal Reserve Board to be effective.

### Preemption Standards and Determinations (§§ 229.20(c) and (d))

The Federal Reserve Board may issue a preemption determination upon request by an interested party in a state. The determination will relate only to the provisions of subparts A and B of Regulation CC.

## Civil Liability—Section 229.21

### Statutory Penalties (§ 229.21(a))

Statutory penalties can be imposed as a result of a successful individual or class action suit brought for violations of subpart B of Regulation CC. Basically, a bank can be held liable for

- Actual damages,
- No less than \$100 nor more than \$1,000 in the case of an individual action,
- The lesser of \$500,000 or 1 percent of the net worth of the bank involved in the case of a class action, and
- The costs of the action, together with reasonable attorney's fees as determined by the court.

These penalties also apply to provisions of state law that supersede provisions of the regulation, such as requirements that funds deposited in accounts at banks be made available more promptly than required by the regulation, but they do not apply to other provisions of state law. (See commentary to appendix D, section 229.20.)

### Bona Fide Errors (§ 229.21(c))

A bank will not be considered liable for violations of Regulation CC if it can demonstrate, by a preponderance of evidence, that violations resulted from bona fide errors and that it maintains procedures designed to avoid such errors.

### Reliance on Federal Reserve Board Rulings (§ 229.21(e))

A bank will not be held liable if it acts in good faith in reliance on any rule, regulation, model form (if the disclosure actually corresponds to the bank's availability policy), or interpretation of the Federal Reserve Board, even if that rule, regulation, form, or interpretation is subsequently determined to be invalid. Banks may rely on the commentary as well as on the regulation itself.

### Exclusions (§ 229.21(f))

The liability established by section 229.21 does not apply to violations of subpart C (Collection of Checks) of Regulation CC or to actions for wrongful dishonor of a check by a paying bank's customer. (Separate liability provisions applying to subpart C are found in section 229.38.)

## SUBPART C— COLLECTION OF CHECKS

Subpart C covers the check-collection system and includes rules to speed the collection and return of checks. Basically, these rules cover the return responsibilities of paying and returning banks, authorization of direct returns, notification of nonpayment on large-dollar returns of the paying bank, and mandatory check endorsement standards.

Sections 229.30 and 229.31 require paying and returning banks to return checks expeditiously using one of two standards: the "two-day/four-day" test and the "forward collection" test. Under the two-day/four-day test, a return is considered expeditious if a local check is received by the depository bank two business days after presentment, and a nonlocal bank four business days after presentment. Under the forward collection test, a return is considered expeditious if the paying bank uses, for returns, transportation methods and banks comparable to those used for forward collection. The paying bank may return checks directly to the depository bank of any bank agreeing to process the returns, including the Federal Reserve.

Subpart C, in section 229.33, also requires a bank to provide notification of nonpayment if it determines not to pay a check of \$2,500 or more, regardless of the channel of collection. The regulation addresses the depository bank's duty to notify its customers that a check is being returned and the paying bank's responsibility for giving notice of nonpayment.

Other areas that are covered in subpart C are endorsement standards, warranties by paying and returning banks, bona fide errors and liability, variations by agreement, insolvency of banks, and the effect of merger transactions.

The provisions of subpart C, section 229.41, supersede any state law, but only to the extent that state law is inconsistent with Regulation CC.

The expeditious-return requirements of section 229.42 do not apply to checks drawn on the U.S. Treasury, U.S. Postal Service money orders, and checks drawn on states and units of general local government that are presented directly to the state or units of general local government and that are not payable through or at a bank.

## SUBPART D—SUBSTITUTE CHECKS

### General Provisions Governing Substitute Checks—Section 229.51

A substitute check for which a bank has provided the warranties described in section 229.52<sup>3</sup> is the legal equivalent of an original check if the substitute check

- Accurately represents all of the information on the front and back of the original check and
- Bears the legend “This is a legal copy of your check. You can use it the same way you would use the original check.”<sup>4</sup>

The reconverting bank must adhere to Regulation CC’s standards for preserving bank endorsements and identifications. A reconverting bank that receives consideration for a substitute check that it transfers, presents, or returns is also the first bank to provide the warranties described in section 229.52 and the indemnity described in section 229.53.

### Substitute Check Warranties and Indemnity—Sections 229.52 and 229.53

Starting with the reconverting bank, any bank that transfers, presents, or returns a substitute check (or a paper or electronic representation of a substitute check) and receives consideration for that check warrants that the substitute check meets the legal-equivalence requirements and that a check that has already been paid will not be presented for subsequent payment.

Such a bank also provides an indemnity to cover losses that the recipient and any subsequent recipient of the substitute check incur because of the receipt of a substitute check instead of the original check.

### Expedited Recredit for Consumers—Section 229.54

Section 229.54(a) sets forth the conditions under which a consumer may make an expedited recredit claim for losses associated with the consumer’s receipt of a substitute check. To use the expedited recredit procedure, the consumer must be able to assert in good faith that

- The consumer’s account was charged for a

3. A person other than a bank that creates a substitute check could transfer that check only by agreement unless and until a bank provides the substitute check warranties.

4. A bank may not vary the language of the legal-equivalence legend.

substitute check that was provided to the consumer,

- The consumer’s account was improperly charged or the consumer has a warranty claim,
- The consumer suffered a loss, and
- The consumer needs the original check or a sufficient copy to determine the validity of the claim.

To make a claim, the consumer must comply with the timing, content, and form requirements in section 229.54(b). This section generally provides that a consumer’s claim must be received by the bank that holds the consumer’s account no later than the fortieth calendar day after the later of

- The calendar day on which the bank mailed (or delivered by a means agreed to by the consumer) the periodic statement describing the contested transaction or
- The calendar day on which the bank mailed (or delivered by a means agreed to by the consumer) the substitute check itself.

Section 229.54(b)(1)(ii) requires the bank to give the consumer an additional, reasonable period of time if the consumer experiences “extenuating circumstances” that prevent timely submission of the claim.

The commentary to section 229.60 provides that the bank may voluntarily give the consumer more time to submit a claim than the rule allows.

Under section 229.54(b)(2)(ii), a complaint is not considered complete, and thus does not constitute a claim, until it contains all of the required information the rule requires. The rule requires that the claim contain<sup>5</sup>

- A description of why the consumer believes the account was improperly charged or the nature of the consumer’s warranty claim,
- A statement that the consumer has suffered a loss, and an estimate of the amount of the loss,
- A reason why the original check (or a copy of the check that is better than the substitute check the consumer already received) is necessary to determine whether the consumer’s claim is valid, and
- Sufficient information to allow the bank to identify the substitute check and investigate the claim.

A bank, at its discretion, may require the consumer to submit the claim in writing. If a consumer makes an oral claim to a bank that requires a written claim, the bank must inform the consumer of the written requirement at that time.

5. If a consumer submits an incomplete complaint, the bank must so inform the consumer and must tell the consumer what information is missing.

Under those circumstances, the bank must receive the written claim by the later of ten business days from the date of an oral claim or the expiration of the consumer's initial forty-day period for submitting a timely claim. As long as the original oral claim fell within the forty-day requirement for notification and a complete written claim was received within the additional ten-day window, the claim meets the timing requirements (sections 229.54(b)(1) and 229.54(b)(3)), even if the written claim was received after the expiration of the initial forty-day period.

### Bank's Action on Claims

Section 229.54(c) requires a bank to act on a consumer's claim no later than the tenth business day after the banking day on which it received the consumer's claim:

- If the bank determines that the consumer's claim is valid, it must recredit the consumer's account no later than the end of the business day after the banking day on which it makes that determination. The amount of the recredit should equal the amount of the consumer's loss, up to the amount of the substitute check, plus interest on that amount if the account is an interest-bearing account. The bank must then notify the consumer of the recredit using the notice discussed below ("Notices Relating to Expedited Recredit Claims").
- If the bank determines that the consumer's claim is invalid, it must notify the consumer of that decision using the notice discussed below ("Notices Relating to Expedited Recredit Claims").
- If the bank has not determined the validity of the consumer's claim by the tenth business day after the banking day on which it received the claim, the bank must recredit the consumer's account for the amount of the consumer's loss, up to the amount of the substitute check or \$2,500, whichever is less. The bank must also recredit interest on that amount if the consumer's account is an interest-bearing account. The bank must send a notice to that effect to the consumer using the notice discussed below ("Notices Relating to Expedited Recredit Claims"). If the consumer's loss was more than \$2,500, the bank has until the end of the forty-fifth calendar day from the date of the claim to recredit any remaining amount of the consumer's loss, up to the amount of the substitute check (plus interest), unless it determines prior to that time that the claim was invalid and notifies the consumer of that decision.

Section 229.54(d) generally requires that recredited funds receive next-day availability. However, a bank that provisionally recredits funds pending further investigation may invoke safeguard exceptions to delay availability of the recredit under

the limited circumstances described in section 229.54(d)(2). The safeguard exceptions apply to new accounts and repeatedly overdrawn accounts and also when the bank has reasonable cause to suspect that the claim is fraudulent. A bank may delay availability of a provisionally recredited amount until the start of the earlier of (1) the business day after the banking day on which the bank determines that the consumer's claim is valid or (2) the forty-fifth calendar day after the banking day on which the bank received the claim if the account is new, the account is overdrawn, or the bank has reasonable cause to believe that the claim is fraudulent. When the bank delays availability under this section, it may not impose overdraft fees on checks drawn against the provisionally credited funds until the fifth calendar day after the day on which the bank sent the notice regarding the delayed availability.

If, after providing the recredit, the bank determines that the consumer's claim was invalid, the bank may reverse the recredit. This reversal must be accompanied by a consumer notification using the notice discussed below ("Notices Relating to Expedited Recredit Claims").

### Notices Relating to Expedited Recredit Claims

Section 229.54(e) outlines the requirements for providing consumer notices related to expedited recredit:

- The bank must send the notice of recredit no later than the business day after the banking day on which the bank recredits the consumer's account. The notice must include the amount of the recredit and the date the recredited funds will be available for withdrawal.
- The bank must send notice that the consumer's claim is not valid no later than the business day after the banking day on which the bank makes this determination. The notice must include the original check or a sufficient copy of it (except as provided in section 229.58; see below). Also, it must demonstrate to the consumer why the claim is not valid. Further, the notice must include either any information or document that the bank used in making its determination or an indication that the consumer may request copies of this information.
- The bank must send the notice of a reversal of recredit no later than the business day after the banking day on which the bank made the reversal. The notice must include all the information required in a notice of invalid claim plus the amount (including interest) and date of the reversal (section 229.54(e)(3)(i)).

Appendix C to Regulation CC contains model forms (models C-23 through C-25) that a bank may use to craft the various notices required in section 229.54(e). The Board published these models to assist banks in complying with section 229.54(e). Appropriate use of the models, however, does not offer banks a statutory safe harbor.

### **Expedited Recredit for Banks— Section 229.55**

Section 229.55 sets forth expedited recredit procedures applicable between banks. A claimant bank must adhere to the timing, content, and form requirements of section 229.55(b) in order for the claim to be valid. A bank against which an interbank recredit claim is made has ten business days within which to act on the claim (section 229.55(c)). The provisions of section 229.55 may be varied by agreement. (No other provisions of subpart D may be varied by agreement.)

### **Liability—Section 229.56**

Section 229.56 describes the damages for which a bank or person would be liable in the event of breach of warranty or failure to comply with subpart D:

- The amount of the actual loss, up to the amount of the substitute check, resulting from the breach or failure and
- Interest and expenses (including costs, reasonable attorney's fees, and other expenses of representation) related to the substitute check.

These amounts could be reduced in the event of negligence or failure to act in good faith. It is also important to note that section 229.56 contains a specific exception that allows for greater recovery as provided in the indemnity section. Thus, a person who has an indemnity claim that also involves a breach of a substitute check warranty could recover all damages proximately caused by the warranty breach.

Section 229.56(b) excuses failure to meet this subpart's time limits because of circumstances beyond a bank's control. Section 229.56(c) provides that an action to enforce a claim under this subpart may be brought in any U.S. district court. Section 229.56(c) also provides the subpart's statute of limitations: one year from the date on which a person's cause of action accrues.<sup>6</sup> Section 229.56(d) states that if a person fails to provide

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6. For purposes of this paragraph, a cause of action accrues as of the date on which the injured person first learns, or reasonably should have learned, of the facts giving rise to the claim, including the identity of the warranting or indemnifying bank against which the action is brought.

notice of a claim for more than thirty days from the date on which a cause of action accrues, the warranting or indemnifying bank is discharged from liability *to the extent of any loss caused by the delay in giving notice of the claim.*

### **Consumer Awareness— Section 229.57**

#### **Content Requirements**

A bank must provide its consumer customers with a disclosure that explains that a substitute check is the legal equivalent of the original check and describes the consumer's recredit rights for substitute checks. A bank may use, but is not required to use, the Board's model form (model C-5A in appendix C to Regulation CC) to meet the content requirements for this notice. A bank that uses the model form appropriately is deemed to be in compliance with the content requirements for which it uses language from the model form. A bank may provide the notice required by section 229.57 along with other information.

#### **Distribution to Consumer Customers Who Receive Canceled Checks with Periodic Account Statements**

Under section 229.57(b)(1), a bank must provide this disclosure to existing consumer customers who routinely receive their canceled checks in their periodic statement no later than the first statement after October 28, 2004. For customer relationships established after that date, a bank must provide the disclosure to a new consumer customer who will routinely receive canceled checks in periodic statements at the time the customer relationship is established.

#### **Distribution to Consumer Customers Who Receive a Substitute Check Occasionally**

Under section 229.57(b)(2), a bank must also provide the disclosure to a consumer customer who receives a substitute check on an occasional basis, including when a consumer receives a substitute check in response to a request for a check or a copy of a check and when a check deposited by the consumer is returned to the consumer as an unpaid item in the form of a substitute check. A bank must provide the disclosure to a consumer customer in these cases even if the bank previously provided the disclosure to the consumer.

When the consumer contacts the bank to request a check or a copy of a check and the bank

responds by providing a substitute check, the bank must provide this disclosure at the time of the request, if feasible. Otherwise, the bank must provide the disclosure no later than when the bank provides a substitute check in response to the consumer's request. It would not be feasible to provide the disclosure at the time of the request if, for example, the consumer made his or her request by telephone or if the bank did not know at the time of the request whether it would provide a substitute check or some other document in response. A bank is not required to provide the disclosure if the bank responds to the consumer's request by providing something other than an actual substitute check (such as a photocopy of an original check or a substitute check).

When a bank returns a deposited item unpaid to a consumer in the form of a substitute check, the bank must provide the disclosure when it provides the substitute check.

### **Mode of Delivery of Information— Section 229.58**

Section 229.58 provides that banks may deliver any notice or other information required under this subpart by U.S. mail or by any other means to which the recipient has agreed to receive account information, including electronically. A bank that is required to provide an original check or a sufficient copy (each of which is defined as a specific paper document) instead may provide an electronic image of the original check or sufficient copy if the recipient has agreed to receive that information electronically.





# Regulation CC

## Examination Objectives and Procedures

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*Note: The examination objectives and examination procedures for this regulation are broken down by regulation subpart: Section I covers subparts A and B, and section II covers subpart D. Subpart C of the regulation, "Collection of Checks," is not covered here, as it addresses payments system issues exclusively and therefore does not present any consumer-related regulatory compliance issues to be reviewed during a consumer compliance examination.*

### I. SUBPARTS A AND B

#### EXAMINATION OBJECTIVES

1. To determine that the financial institution's funds availability policies are in compliance with Regulation CC
2. To determine that the financial institution has established internal controls for compliance with Regulation CC
3. To determine that the financial institution has established a training program for applicable employees concerning their duties with respect to Regulation CC
4. To determine that the financial institution maintains records of compliance with Regulation CC for a period of two years

#### EXAMINATION PROCEDURES

A financial institution may delay funds availability for some deposits on a case-by-case basis and for other deposits on an automatic basis. In addition, the institution may make decisions concerning holds and maintain records at branches as well as at the main office. Therefore, to check on an institution's compliance with its holds policies, the examiner must determine not only the types of holds policies the institution has, but how decisions are made and where records are maintained. If a branch makes its own decision and maintains its own records, such as in a decentralized structure, sampling may be done at the branch. If decisions to delay availability are either centralized or made at a regional processing center and records are maintained there, sampling for compliance may be made at that location.

#### General

1. Determine the types of transaction accounts, as defined in Regulation D, section 204.2(e)

(demand deposits, NOW accounts, and ATS accounts), offered by the financial institution.

2. Obtain copies of the forms used by the institution for transaction accounts, as applicable:
  - Specific availability policy disclosures
  - Exception hold notices
  - Case-by-case hold notices
  - Special deposit slips
  - Change-in-terms notices
3. Determine, by account type, the institution's specific funds availability policies with regard to deposits.
4. Determine which individuals actually perform the various activities necessary to comply with the provisions of Regulation CC, subpart B, including, for example, personnel engaged in
  - Distributing disclosure statements
  - Employee training
  - Internal reviews
  - Computer program development for deposit accounts (not necessarily a computer programmer)
  - Deposit operations
  - Overdraft administration
  - ATM deposit processing
  - Determining case-by-case holds or exceptions
5. Review the institution's training manual, internal audit or similar reports for Regulation CC, written procedures given to employees detailing their responsibilities under the regulation, and similar materials.
6. Determine the extent and adequacy of the instruction and training received by those employees to enable them to carry out their assigned responsibilities in conformance with Regulation CC.
7. Verify that the institution provides each employee with a written statement regarding the institution's procedures that pertain to that employee's function. (§ 229.19(f))

#### Initial Disclosures and Subsequent Changes

1. Review the financial institution's specific availability policy disclosures. Determine if the disclosures accurately reflect the institution's funds availability policies and meet the requirements for content under section 229.16.

2. Determine if the institution provides the initial disclosure statement prior to accepting funds to open a new transaction account, or mails the disclosures within one business day of receiving a written request by mail or telephone to open a new account. (§ 229.17(a))
3. Determine if the institution provides its funds availability policy upon an oral or written request within a reasonable time period. (§ 229.18(d))
4. Determine if the institution has made changes to its availability policies since the last examination. If it has, determine whether depositors were notified in accordance with section 229.18(e).

### Automatic (or Automated) Hold Policies

1. Review the financial institution's schedules or other materials relating to its funds availability time periods for the following types of deposits:
  - Cash (§ 229.10(a))
  - Electronic payments (§ 229.10(b))
  - U.S. Treasury checks (§§ 229.10(c)(1)(i) and 229.12(b)(2))
  - U.S. Postal Service money orders (§§ 229.10(c)(1)(ii), 229.10(c)(2), and 229.12(b)(3))
  - Checks drawn on Federal Reserve Banks and Federal Home Loan Banks (§§ 229.10(c)(1)(iii), 229.10(c)(2), 229.12(b)(4), and 229.12(c)(1)(ii))
  - State or local government checks (§§ 229.10(c)(1)(iv), 229.10(c)(2), 229.12(b)(4), and 229.12(c)(1)(ii))
  - Cashier's, certified, and teller's checks (§§ 229.10(c)(1)(v), 229.10(c)(2), 229.12(b)(4), and 229.12(c)(1)(ii))
  - On-us checks (§§ 229.10(c)(1)(vi) and 229.11(c)(1)(ii))
  - Local checks (§ 229.12(b)(1))
  - Nonlocal checks (§ 229.12(c)(1)(i))
  - Credit union share draft accounts (commentary to § 229.16(b))
2. Determine that the institution's policy for providing funds availability is in accordance with regulatory requirements.
3. Determine the institution's procedures for placing holds.
4. Selectively sample each of the types of deposits listed in item 1 and verify the funds availability time frames. Determine, for each deposit category, whether the financial institution's procedures provide funds availability within the

required time periods. Determine that the procedures and disclosed policy are the same.

### Deposits at Nonproprietary ATMs—Section 229.12(f)

*(See also sections 229.19(a)(4) and 229.19(a)(5)(ii) and commentary to sections 229.19(a) and 229.19(b) for off-premises ATMs.)*

1. Determine that the institution makes funds deposited in an account at a nonproprietary ATM by cash or check available for withdrawal not later than the fifth business day following the day of deposit.

### Availability Rules—\$100 and \$400—Sections 229.10(c)(1)(vii) and 229.11(b)(2)

1. Determine the financial institution's procedures for complying with the \$100 availability rule and, if applicable, the \$400 cash withdrawal rule.
2. Review records that detail holds placed on accounts. Determine if holds are in accordance with the regulation.
3. Sample deposit accounts with deposits subject to the \$100 availability rule and the \$400 cash withdrawal rule and verify the institution's compliance with the rules. Verify that actual practices and policies match.

### Extended Holds

#### Case-by-Case Holds

1. Determine if the financial institution places holds on a case-by-case basis. If it does, review the institution's procedures for placing case-by-case holds.
2. Review the institution's specific availability policy disclosures to determine whether the case-by-case hold policy has been disclosed.
3. Review any physical records or reports generated from holds placed. (Sample should include records from the main office as well as branch offices, depending on the type of branch system operated.)
4. Sample a few of the case-by-case holds and determine whether the institution makes the funds available for withdrawal within the required time frames.
5. Determine whether the institution provides the customer with a notice of the case-by-case hold as required by section 229.16(c)(2). Determine if the notices meet the timing and content requirements.

6. If the institution does not provide the notice at the time of deposit, determine whether it either discloses the availability of refunds of overdraft and returned-check fees or does not assess these fees when the requirements of section 229.16(c)(3) are met.

### Exception Holds (§ 229.13)

1. Determine whether the financial institution places holds on an exception basis. If it does, review its procedures for placing exception holds.
2. Review the institution's specific availability policy disclosures to determine whether it has disclosed its exception-holds policy.
3. Review any physical records or reports generated from holds placed. (Sample should include records from the main office as well as branch offices, depending on the type of branch system operated.)
4. Sample a few of the exception holds and determine when the institution makes the funds available for withdrawal. Determine that the institution does not add more than one business day for on-us checks, five business days for local checks, and six business days for nonlocal checks to the maximum time periods in the federal availability schedule for the deposit unless it can show that a longer delay is reasonable. (§ 229.13(h))
5. With the exception of new accounts, determine whether the institution provides the customer with an exception-hold notice as required by section 229.13(g).
6. Review hold notices. Determine if the notices meet the timing and content requirements for each type of exception hold. (Note: Institutions are required to retain copies of reasonable-cause hold notices.)

### New Accounts (§ 229.13(a))

1. Review financial institution policies for new accounts.
2. Determine how the institution defines a new-account relationship. Determine if the institution's definition is in compliance with Regulation CC.
3. Review the institution's specific availability policy disclosure to determine whether the institution has disclosed its availability policy regarding new accounts.
4. Review a new-account report or listing of new-account holders. Determine if any holds were placed on the accounts.
5. Sample deposit accounts, and ask the institution to provide documentation concerning the

composition of the opening deposit or the most recent deposit.

6. Review holds placed and determine if they are within regulatory limits with respect to time and amount (see section 229.13(a)(1)). (Note: No regulatory time limits are set forth for funds availability for local and nonlocal check deposits into new accounts.)

### Large Deposits (§ 229.13(b))

1. Determine whether the financial institution has procedures and a special hold policy for large deposits. If it does, determine whether the institution considers a large deposit, for purposes of the large-deposit exception, to be a day's aggregate deposit of checks exceeding \$5,000.
2. Determine that the institution does not invoke the large-deposit exception for cash or electronic payments.
3. Review at least one account deposit on which a large-deposit hold was placed and ensure that the hold was placed only on the amount by which a day's deposits of checks exceeded \$5,000.
4. Determine if the institution provided the customer with a written exception notice that meets the requirements of section 229.13(g)(1) or 229.13(g)(2).
5. Determine if the notice was provided within the time frames prescribed in section 229.13(g)(1) or 229.13(g)(2).

### Redeposited Checks (§ 229.13(c))

1. Determine if the financial institution has procedures and a special hold policy for redeposited checks.
2. If it does, determine if the institution refrains from imposing this exception solely because of a missing endorsement or because the check was postdated.
3. Determine if the institution provided the customer with a written exception notice that meets the requirements of section 229.13(g)(1) or 229.13(g)(2).
4. Determine if the notice was provided within the time frames prescribed in section 229.13(g)(1) or 229.13(g)(2).

### Repeated Overdrafts (§ 229.13(d))

1. Determine whether the financial institution has procedures or a special hold policy for customers with repeated overdrafts.

2. If it does, review the institution's definition of accounts "repeatedly overdrawn" and determine whether it meets the regulatory definition in section 229.13(d).
3. Determine that the institution returns the account to the institution's normal account status when the account has not been repeatedly overdrawn for a six-month period following the time the account was characterized as repeatedly overdrawn.
4. Review the financial institution's list of customers whose accounts are repeatedly overdrawn. (Note: This list may or may not be the same overdraft list maintained in the ordinary course of business. The institution may maintain a list of recent overdrafts as well as a list of customers whose accounts are repeatedly overdrawn.)
5. Review an account classified as repeatedly overdrawn. Determine if the institution properly classified the account and followed the regulatory procedures outlined in section 229.13(d).
6. Determine the date the account was placed in "repeated overdraft" exception status. Review account statements for the six months before the account was identified as an overdraft exception.
7. Determine whether the institution provided the customer with an exception notice when an exception hold was placed on the account. If it did, review the content of the notice and determine if it meets the requirements of section 229.13(g)(1) or 229.13(g)(3).
8. Determine if notice was given within the required time frames. (§ 229.12(g)(1) or 229.12(g)(3))

#### Reasonable Cause to Doubt Collectibility (§ 229.13(e))

1. Determine if the financial institution has procedures or a special policy for placing reasonable-cause holds.
2. If it does, determine who initiates reasonable-cause holds.
3. Obtain a list of accounts or checks to which this exception was applied. Review the exception notice given to the customer.
4. Determine if the reason for invoking the exception was reasonable.
5. Review the content of the notice and determine if it meets the requirements of section 229.13(g)(1).
6. Determine if notice was given within the required time frames. (§ 229.13(g)(1))
7. If the institution imposes a reasonable-cause exception hold and does not provide the notice at the time of deposit, determine whether it

either discloses the availability of refunds of overdraft and returned-check fees or does not assess these fees when the requirements of section 229.13(e)(2) are met.

#### Emergency Conditions (§ 229.13(f))

1. Determine if the financial institution has procedures or a special policy for placing emergency-condition holds. If it does, review the institution's procedures for placing these holds.
2. Determine whether the institution invokes this exception only under the conditions specified in section 229.13(f).
3. Determine whether the institution makes the funds available for withdrawal within a reasonable time after either the termination of the emergency or the time at which the deposit would normally be available for withdrawal, whichever is later. (Note: A reasonable period for on-us checks is one business day; for local checks, five business days; and for nonlocal checks, usually six days. (§§ 229.13(h)(3) and 229.13(h)(4))

#### Miscellaneous Provisions

##### Special Deposit Slips (§ 229.10(c)(3))

1. Determine if the financial institution requires a special deposit slip for state or local government, cashier's, certified, or teller's checks in order to provide next-business-day availability on the deposits. (§ 229.10(c)(3)(i))
2. If the institution requires a special deposit slip, determine that it does one of the following: (§ 229.10(c)(3)(ii))
  - Provides the deposit slip to its customers
  - Informs its customers of how to obtain and prepare the slips
  - Makes the special deposit slips "reasonably available"

##### Additional Disclosure Requirements (§ 229.18)

1. Determine if the financial institution displays a notice of its availability policy in a conspicuous place at locations where employees receive consumer deposits. (§ 229.18(b)) (Note: The notice is not required at drive-up windows and night depositories. See commentary to section 229.18(b).)
2. Determine if the institution displays a notice at each of its proprietary ATMs stating that the funds deposited in the ATM may not be available for immediate withdrawal. (§ 229.18(c)(1))

3. If the institution has off-premises ATMs from which funds are not collected more than twice a week, determine if the institution discloses on or at the ATM the days on which the deposits made at the ATM will be considered “received.” (§ 229.18(c)(2))
4. Determine if the institution includes a notice on all preprinted deposit slips that the deposited funds may not be available for immediate withdrawal. (§ 229.18(a))

### Payment of Interest—Section 229.14

1. Determine whether the financial institution pays interest as of the date of the deposit or as of the date provisional credit is granted.
2. If the institution pays interest as of the date provisional credit is granted, review the institution’s schedule for provisional credit. (This schedule may be from a Federal Reserve Bank or may be based on the time credit is generally received from a correspondent bank.) Select a NOW account statement and ask the institution to give a detailed explanation of how the interest was calculated.
3. Review the institution’s method for calculating interest on deposits reviewed. Select another NOW account and, using the institution’s procedures for calculating interest, verify that the institution accrues interest as of the date provisional credit is received.

### Calculated Availability— Nonconsumer Transaction Accounts— Section 229.19(d)

1. Determine if the financial institution uses a formula for calculating funds availability for nonconsumer transaction accounts.
2. If it does, review a copy of the institution’s formula.
3. Select a large corporate account subject to the formula. Ask the institution to demonstrate how funds are made available to the customer. Determine whether it appears that the formula accurately reflects the type of deposit mix reasonably expected for this type of account holder. (For example, a local grocery store may have 90% of its deposits made up of local check deposits. Therefore, a formula providing a deposit mix of at least 90% availability within two days may be reasonable. A mail order firm, on the other hand, may have a large percentage of nonlocal checks in its check deposits. Therefore, the institution’s formula may allow for lengthier availability schedules.)

### Record Retention— Sections 229.21(g) and 229.13(g)(4)

1. Determine that the financial institution retains for two years the notices required when a “reasonable cause” exception is invoked.

## II. SUBPART D

### EXAMINATION OBJECTIVES

1. Determine the financial institution’s compliance with subpart D notice content and timing requirements (general consumer-awareness disclosures regarding substitute checks and notices that respond to a consumer’s expedited recredit claim regarding a substitute-check error)
2. Ascertain whether the financial institution complies with timing requirements for acting on a substitute-check expedited recredit claim.

### EXAMINATION PROCEDURES

Whether a financial institution will or will not function as a “reconverting bank,”<sup>1</sup> the interlinked nature of the payments system virtually guarantees that every financial institution will at some time receive a substitute check that is subject to the provisions of subpart D, the “Check 21” section of Regulation CC. While some financial institutions will rapidly migrate toward electronic check exchange, others will proceed more hesitantly. Regardless, because the Check 21 Act provides that a properly prepared substitute check is the “legal equivalent of the original check for all purposes,” all banks must be prepared to *accept* a substitute check in place of the original after the act’s effective date of October 28, 2004.

One of a bank’s regulatory compliance obligations is to apprise consumer customers who receive canceled checks with their periodic account statements or who otherwise occasionally receive substitute checks of their rights under the new law through a consumer-awareness disclosure. A bank that provides a substitute check to a consumer must also be prepared to comply with the Check 21 Act’s expedited recredit procedure for addressing errors relating to substitute checks. Even if the customer does not receive actual canceled checks in a monthly statement but instead receives a truncated summary, the individual may eventually receive a substitute check, either in response to a request for a check or a copy of a check or

1. A *reconverting bank* is the bank that creates a substitute check; if a nonbank creates a substitute check, the reconverting bank is the first bank to transfer, present, or return the substitute check (or the first paper or electronic representation of that substitute check) for consideration.

because a check that the consumer deposited was returned unpaid to the consumer in the form of a substitute check. Some increase in the potential for duplicate posting (substitute check and original) may also involve a degree of consumer education and explanation. The regulation specifies the appropriate timing for the distribution of the consumer-awareness disclosure and also provides model language. Finally, institutions will likely want to train their personnel so that they can adequately convey to customers the impact of this new instrument in the payments system.

## General

1. Obtain copies of the documents associated with the financial institution's Check 21 compliance, including but not limited to the following:
  - Consumer-awareness disclosure(s)
  - Sample (test) substitute checks, *if available*
  - Direct mail correspondence, statement stuffers, and the like, describing Check 21/substitute check implementation to consumer customers
  - Notices relating to expedited recredit claims:
    - Notice of valid claim and refund
    - Notice of provisional refund
    - Denial of claim
    - Reversal of refund
  - Any other relevant documents
2. Identify the individuals within the institution who may have responsibilities associated with Check 21. The following is a non-exhaustive list of such individuals:
  - New-accounts personnel
  - Employee training department
  - Internal auditors, reviewers
  - Deposit operations, bookkeeping
3. Review the institution's training manual, internal audit or similar reports for Regulation CC, written procedures given to employees detailing their responsibilities under the regulation, and similar materials.
4. Determine the training methods used by the institution in conveying specific responsibilities to employees. Are written procedures distributed to employees?

## Consumer Awareness— Section 229.57

(Note: Model disclosure language is provided in appendix C of the regulation.)

Determine whether the bank distributes only a single version of its consumer-awareness disclosure or maintains variations of the disclosure to be used depending on the circumstances giving rise to distribution. Each notice should reflect the following:

1. General disclosure content—Determine whether the disclosure notice states
  - That a substitute check is the legal equivalent of an original check and (§ 229.57(a)(1))
  - The consumer recredit rights that apply when a consumer in good faith believes that a substitute check was not properly charged to his or her account. (§ 229.57(a)(2))
2. Timing and distribution—A bank is required to provide its consumer customers with a consumer-awareness disclosure prior to the receipt of a substitute check.
  - For those who receive canceled checks with periodic statements:
    - Existing customers as of October 28, 2004—Determine that the bank provided the disclosure no later than the first regularly scheduled communication with the consumer after October 28, 2004 (for each consumer who is a customer of the bank on that date). (§ 229.57(b)(1)(i))
    - New customers after October 28, 2004—Determine that the bank provided the disclosure at the time the customer relationship was established. (§ 229.57(b)(1)(ii))
  - For those who do not receive canceled checks with periodic statements and who will receive substitute checks only occasionally:
    - Upon customer request for an original check or a copy of a check—Determine that the bank provides the disclosure to a consumer customer who requested an original check or a copy of a check and received a substitute check in response. (§ 229.57(b)(2)(i))
    - Upon customer's receipt of a returned substitute check—Determine that the bank provides the disclosure to a consumer customer of the bank who receives a returned substitute check (at the time the bank provides such substitute check). (§ 229.57(b)(2)(ii))
3. Mode of delivery of information (§ 229.58)—Determine whether the bank employed one of the following in delivering its consumer-awareness disclosure(s) and expedited recredit notice(s):
  - U.S. mail

- Any other means to which the recipient agreed to receive account information, including electronically

## Expedited Recredit for Consumers— Section 229.54

1. Determine whether any financial institution customer has raised a Check 21-related claim of loss since the last examination. If yes, review for the following. (At financial institutions at which multiple Check 21-related claims have been raised and resolved, the examiner need only review a sampling sufficient to ensure that the bank's processing is consistent and in compliance with subpart D.)

- Necessary preconditions (consumer must allege *all* of these)—( §§ 229.54(a)(1)–229.54(a)(4)
  - Was the consumer's account charged for a substitute check *that was provided to the consumer*? (The consumer need not be in possession of the substitute check at the time of claim submission.)
  - Was the consumer's account not properly charged? (Alternatively, a consumer's account could be properly charged yet still give rise to a warranty claim, for example, in the case of a substitute-check image that is illegible.)
  - Did the consumer suffer a resulting financial loss?
  - Was the production of the original check or a sufficient copy necessary to determine whether or not the consumer's claim was valid?
- Procedural steps for consumer's claim
  - Did the consumer submit a timely claim? (§ 229.54(b)(1))
  - Did the claim contain a description of the claim, a statement and estimate of loss, the reason why the original check or a sufficient copy is necessary, and sufficient information for the bank to investigate? (§ 229.54(b)(2))
  - If the consumer attempted to make a claim but failed to provide all of the necessary information (as listed above), did the bank inform the consumer that the claim was incomplete and identify the information that was missing? (§ 229.54(b)(2)(D)(ii))
  - Was the claim submitted in a form acceptable to the financial institution? Did the bank compute the time for action accurately? (§ 229.54(b)(3))

- Procedural steps for financial institution response—If the financial institution concluded that (1) all necessary prerequisites to the filing of a consumer claim existed and (2) the consumer followed the appropriate steps in filing the claim, verify that the bank provided the following appropriate response:

### *Claim deemed valid:*

In the event of a valid consumer claim, did the bank

- Recredit the account for the amount of the loss, up to the amount of the substitute check (plus interest, if applicable), no later than the end of the business day after the banking day on which the bank made its determination, (§ 229.54(c)(1)(i))
- Draft a notice of recredit stating (1) the amount of the recredit and (2) the date on which funds will be available for withdrawal, and (§§ 229.54(e)(1)(i) and 229.54(e)(1)(ii))
- Send the notice no later than the business day after the banking day on which the bank recredit occurred? (§ 229.54(e)(1))

### *Claim deemed invalid:*

In the event of an invalid consumer claim, determine whether the bank

- Sent a notice stating that the claim was invalid and included the original check or a sufficient copy, (§ 229.54(e)(2)(i))
- Demonstrated to the consumer that the substitute check was properly charged (or that the consumer's warranty claim was not valid), and (§ 29.54(e)(2)(ii))
- Included the information or documents (in addition to the original check), if any, relied upon by the bank in making its determination (or a statement that the consumer may request such). (§ 229.54(e)(2)(iii))

### *Claim not resolved within initial ten days, pending further investigation:*

If the bank could not resolve the claim before the end of the tenth business day after the banking day on which the bank received the claim, determine whether the bank

- Recredited the consumer's account for the amount of the loss, up to the lesser of the amount of the substitute check or \$2,500 (plus interest, if applicable), (§ 229.54(c)(3)(i)(A))
- Drafted a notice of recredit stating (1) the amount of the recredit and (2) the date on which the funds would be available for withdrawal, (§§ 229.54(e)(1)(i) and 229.54(e)(1)(ii))



- Recredited the consumer’s account for the remaining amount of the loss, if any, up to the amount of the substitute check (plus interest, if applicable), no later than the end of the forty-fifth calendar day after the banking day on which the bank received the claim, and (§ 229.54(c)(3)(ii))
- Sent the notice of recredit no later than the business day after the banking day on which the bank recredit occurred. (§ 229.54(e)(1))

*Claim resulting in reversal of recredit:*

In some instances it may be necessary for a bank to reverse a recredit made previously to a consumer’s account (plus any interest paid, if applicable). If such a circumstance has occurred, determine whether the bank

- Concluded that the consumer’s claim was not valid and (§ 229.54(c)(4)(i))
- Drafted a notice of reversal of recredit (§ 229.54(e)(3)), accompanied by the following:
  - The original check or a sufficient copy, (§ 229.54(e)(2)(i))
  - Information or explanation to demonstrate to the consumer that the substitute check was properly charged (or that the consumer’s warranty claim was not valid), (§ 229.54(e)(2)(ii))
  - Information or documents (in addition to the original check or a sufficient copy), if any, on which the bank relied in making its determination (or a statement that the consumer can request such), (§ 229.54(e)(2)(iii))
  - A description of the amount of the reversal, including both the amount of the recredit and the amount of interest

paid on the recredited amount, if any, being reversed, and (§ 229.54(e)(3)(i))

- The date on which the bank made the reversal. (§ 229.54(e)(3)(ii))
- Sent the notice no later than the business day after the banking day on which the bank made the reversal (§ 229.54(e)(3))
- Availability of recredited funds—Under circumstances detailed above, when the financial institution determined that it was appropriate to recredit its consumer customer’s account, determine whether the bank took the following actions:
  - *Next day availability*—Did the bank make any recredited amount available for withdrawal no later than the start of the business day after the banking day on which the recredit was provided? (§ 229.54(d)(1))
  - *Safeguard exceptions*—If necessary for reasons of (1) new-account status, (2) overdrawn-account status, or (3) well-reasoned suspicion of fraud, did the bank invoke its right to delay immediate availability of recredited funds? If so, was the delay invoked because the bank had not yet determined the validity of the claim? Were the funds made available no later than the business day after the banking day on which the final determination was made or the forty-fifth calendar day after the bank received the claim, whichever occurred earlier? (§ 229.54(d)(2))
  - *Overdraft fees*—If the bank chose to invoke its right to delay immediate availability of recredited funds, did it refrain from imposing an overdraft fee until the appropriate five-day period had elapsed? (§ 229.54(d)(3))

# Regulation CC Examination Checklist

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## General Operations

### Date of Deposit

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|--|-----|----|
| 1. Does the bank consider every day except Saturday, Sunday, and federal holidays a "business day"? (§ 229.2(g))   | Yes | No |
| 2. Does the bank consider "banking days" those business days on which an office of the bank is open for substantially all of its business? (§ 229.2(f))  | Yes | No |
| 3. Does the bank have a cutoff for receipt of deposits of 2:00 p.m. or later for bank offices and 12:00 noon or later for ATMs? (§ 229.19(a)(5)(ii))   | Yes | No |
| 4. Does the bank comply with the following rules in determining when funds are considered to have been deposited?  |     |    |
| A. Deposits over the counter or at ATMs are considered deposited when "received." (§ 229.19(a)(1))   | Yes | No |
| B. Mail deposits are considered deposited when they are received by the mail room of the bank. (§ 229.19(a)(2))  | Yes | No |
| C. Deposits in a night depository, lock box, or similar facility are considered received when the deposits are removed from the facility and are available for processing. (§ 229.19(a)(3))  | Yes | No |
| D. Deposits at an off-premises ATM (not within fifty feet of the bank) that is not serviced more than twice a week are considered received as of the date the deposits are removed from the ATM by the bank. (§ 229.19(a)(4))                          | Yes | No |
| 5. Does the bank consider deposits made on a nonbanking day to have been received no later than the next banking day? (§ 229.19(a)(5)(i))  | Yes | No |
| 6. When funds must be available on a given "business day," does the bank make the funds available at the later of 9:00 a.m. or the time the bank's teller facilities (including ATMs) are available for account withdrawals? (§ 229.19(b))             | Yes | No |
| 7. If the bank limits cash withdrawals, does it make \$400 available for cash withdrawals no later than 5:00 p.m. on the appropriate business day (second day for local checks, fifth for nonlocal checks) following the day of deposit? (§ 229.12(d)) | Yes | No |

### Required Next-Day Availability

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|--|-----|----|
| 8. Does the bank make funds from the following types of deposits available for withdrawal no later than the first business day following the date of deposit?  |     |    |
| A. Electronic payments (§ 229.10(b))   | Yes | No |
| B. Checks drawn on the U.S. Treasury and deposited to the payee's account (§ 229.10(c)(1)(i))  | Yes | No |
| C. On-us checks and checks that are drawn on and deposited in branches of the same bank in the same state or check-processing region (§ 229.10(c)(1)(vi))  | Yes | No |
| 9. Does the bank make funds from the following deposits available no later than the first business day after the day of deposit if the deposit is made in person to a bank employee, or no later than the second business day if the deposit is not made in person to a bank employee? |     |    |
| A. Cash deposits (§§ 229.10(a)(1) and 229.10(a)(2))  | Yes | No |

B. U.S. Postal Service money orders deposited in an account held by the payee of the check (§§ 229.10(c)(1)(ii) and 229.10(c)(2))	Yes	No
C. Checks drawn on a Federal Reserve Bank or Federal Home Loan Bank deposited in an account held by the payee of the check (§§ 229.10(c)(1)(iii) and 229.10(c)(2))	Yes	No
D. Checks drawn by a state or local governmental unit and deposited		
• In an account held by the payee of the check, (§§ 229.10(c)(1)(iv)(A) and 229.10(c)(2))	Yes	No
• In a depository bank located in the same state as the governmental unit issuing the check, and (§§ 229.10(c)(1)(iv)(B) and 229.10(c)(2))	Yes	No
• Accompanied by a special deposit slip (if required by the bank to make the funds available on the next business day). (§§ 229.10(c)(1)(iv)(D) and 229.10(c)(3))	Yes	No
E. Cashier's checks, certified checks, and teller's checks (as defined in section 229.2) deposited in an account held by the payee of the check when		
• The check is accompanied by a special deposit slip (if required by the bank to make the funds available on the next business day) (§§ 229.10(c)(1)(v)(C) and 229.10(c)(3))	Yes	No
10. If the bank requires the special deposit slips, for the checks covered in checklist items 9(D) and 9(E), does it provide the slip to its customers or tell its customers how to prepare or obtain the slips? (§ 229.10(c)(3)(ii))	Yes	No
Are the special deposit slips reasonably available? (§ 229.10(c)(3)(ii))	Yes	No
11. Is the first \$100 of a customer's daily aggregate deposits of checks not subject to the next-day availability rules available on the next business day? (§ 229.10(c)(1)(vii))	Yes	No
12. Is the \$100 in addition to other deposited amounts that must be afforded next-day availability? (§229.10(c)(1)(vii))	Yes	No

### Local Checks and Certain Other Deposits

13. Are funds from local checks generally available no later than the second business day after the day of deposit? (§ 229.12(b)(1))	Yes	No
14. If a bank limits cash withdrawals, (§ 229.12(d))		
A. Is the \$100 available on the next business day after the day of deposit for withdrawal in cash or by check?	Yes	No
B. Is the \$400 available for cash withdrawal sometime before 5:00 p.m. on the second business day after the day of deposit?	Yes	No
C. Are any remaining funds available for withdrawal the business day after the \$400 was made available?	Yes	No
15. For Treasury checks and U.S. Postal Service money orders that do not meet the criteria for next-day (or second-day) availability, does the bank make funds available no later than the second business day after the date of deposit? (§§ 229.12(b)(2) and 229.12(b)(3))	Yes	No
16. Are funds deposited by cash or check at a nonproprietary ATM available no later than the fifth business day after the banking day of deposit? (§ 229.12(f))	Yes	No

## Nonlocal Checks

- |   |     |    |
|---|-----|----|
| 17. Are funds from nonlocal checks generally available no later than the fifth business day after the day of deposit? (§ 229.12(c)(1))  | Yes | No |
| 18. If the bank is located in a city listed in appendix B to Regulation CC, does it have procedures to make funds for certain nonlocal checks available on a shorter schedule as required by the appendix? (§ 229.12(c)(2)) | Yes | No |
| 19. If the bank limits cash withdrawals, (§ 229.12(d))  |     |    |
| A. Is \$100 available on the next business day after the day of deposit for withdrawal in cash or by check?   | Yes | No |
| B. Is \$400 available for cash withdrawal sometime before 5:00 p.m. on the fifth business day after the day of deposit?   | Yes | No |
| C. Are any remaining funds available for cash withdrawal on the business day after the \$400 is made available?   | Yes | No |

## Payable-Through Checks

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|--|-----|----|
| 20. Does the bank's policy distinguish between local and nonlocal checks (are funds from local and nonlocal checks available on the second business day following the day of deposit)? (§ 229.16(b)(2), footnote 3(a)) | Yes | No |
| 21. If local and nonlocal checks are treated differently,  |     |    |
| A. Does the policy state that payable-through checks will be treated as local or nonlocal based on the location of the bank where the check is payable? (§ 229.16(b)(2))   | Yes | No |
| B. Does the policy do one of the following? (§229.16(b)(2), footnote 3(a))   |     |    |
| • Describe how the customer can determine whether the checks will be treated as local or nonlocal or   | Yes | No |
| • State that special rules apply and that the customer may ask about the availability of these checks  | Yes | No |

## Extended Holds

### Case-by-Case Holds

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|---|-----|----|
| 22. Does the bank's specific availability policy disclosure indicate that case-by-case holds may be placed? (§ 229.16(c)(1))  | Yes | No |
| If it does, does the disclosure do the following?   |     |    |
| A. State that the bank may extend the time period when deposited funds are available for withdrawal (§ 229.16(c)(1)(i))   | Yes | No |
| B. State the latest time a deposit will be available for withdrawal, if the availability time frame is extended (§ 229.16(c)(1)(i))   | Yes | No |
| C. State that the bank will notify the customer if funds from a particular deposit will not be available for withdrawal until after the time period stated in the bank's funds availability policy (§ 229.16(c)(1)(ii)) | Yes | No |
| D. Encourage customers to ask when particular deposits will be made available for withdrawal (§ 229.16(c)(1)(iii))  | Yes | No |
| 23. When case-by-case holds are placed, does the bank provide the customer with a written notice of the hold? (§ 229.16(c)(2))  | Yes | No |
| 24. Does the notice include the following?  |     |    |
| A. The customer's account number (§ 229.16(c)(2)(i)(A))   | Yes | No |

B. The date and amount of the deposit (§ 229.16(c)(2)(i)(B))	Yes	No
C. The amount of the deposit that is being delayed (§ 229.16(c)(2)(i)(C))	Yes	No
D. The day the funds will be available for withdrawal (§ 229.16(c)(2)(i)(D))	Yes	No
25. Does the bank provide the notice at the time the deposit is made, if the deposit is made to an employee of the depository bank? (§ 229.16(c)(2)(ii))	Yes	No
26. If the notice is not given at the time of deposit, does the depository bank mail or deliver the notice to the customer not later than the first business day after the day of the deposit? (§ 229.16(c)(2)(ii))	Yes	No
27. If the bank does not provide the notice at the time of deposit, does it refrain from charging the customer overdraft or return check fees if		
A. The overdraft or other fee would not have occurred if the deposited check had not been delayed and	Yes	No
B. The deposited check was paid by the paying bank (§ 229.16(c)(3))	Yes	No
28. If the bank does not provide the notice at the time of deposit and charges overdraft fees, does it notify the customer of the right to a refund of such fees and how to obtain the refund? (§ 229.16(c)(3))	Yes	No
29. Does the bank refund the fees if the conditions listed in checklist item 27 above are met and the customer requests a refund? (§ 229.16(c)(3))	Yes	No

### Exception-Based Holds

30. When invoking an exception hold for accounts other than new accounts, does the bank provide the customer with a written notice that includes the following?		
A. The customer's account number (§ 229.13(g)(1)(i)(A))	Yes	No
B. The date and amount of the deposit (§ 229.13(g)(1)(i)(B))	Yes	No
C. The amount of the deposit that is being delayed (§ 229.13(g)(1)(i)(C))	Yes	No
D. The reason the exception was invoked (§ 229.13(g)(1)(i)(D))	Yes	No
E. The day the funds will be available for withdrawal (unless the emergency-conditions exception is invoked and the bank does not know when the funds will become available) (§ 229.13(g)(1)(i)(E))	Yes	No
31. Does the bank refrain from delaying funds availability beyond a reasonable time period? (Note: Five days for local checks and six days for nonlocal checks is considered reasonable.) (§ 229.13(h)(4))	Yes	No

### Exceptions

#### New Accounts (§ 229.13(a))

32. Does the bank's definition of a new account comply with the definition under section 229.13(a)(2)? (Note: If a customer has had another transaction account at the bank within the thirty days prior to opening an account, the customer does not qualify for the new-account exception.)	Yes	No
33. If the bank's definition is different, does it delay availability to new-account holders beyond the limits set forth in the regulation?	Yes	No
34. Do bank disclosures accurately reflect the bank's practice for making deposited funds available for new accounts?	Yes	No
35. Do cash deposits made in person to a bank employee become available for withdrawal on the first business day following the day of deposit? (§§ 229.13(a)(1)(i) and 229.10(a)(1))	Yes	No

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|---|-----|----|
| 36. Are cash deposits not made in person to a bank employee available for withdrawal on the second business day following the day of deposit? (§§ 229.13(a)(1)(i) and 229.10(a)(2))   | Yes | No |
| 37. Are electronic transfers into new accounts available for withdrawal on the business day following the day the transfer is received? (§§ 229.13(a)(1)(i) and 229.10(b))  | Yes | No |
| 38. Is the first \$5,000 from any of the following types of check deposits available for withdrawal from a new account not later than the first business day after the day of the deposit, if the deposits meet the requirements of section 229.10(c)? (§ 229.13(a)(1)(ii)) (For more information, see checklist section "Required Next-Day Availability.") |     |    |
| A. Treasury checks (§ 229.10(c)(1)(i))  | Yes | No |
| B. U.S. Postal Service money orders (§ 229.10(c)(1)(ii))  | Yes | No |
| C. Federal Reserve and Federal Home Loan Bank checks (§ 229.10(c)(1)(iii))  | Yes | No |
| D. State or local government checks (§ 229.10(c)(1)(iv))  | Yes | No |
| E. Cashier's, certified, and teller's checks (§ 229.10(c)(1)(v))  | Yes | No |
| F. Traveler's checks (§ 229.10(c)(1)(vi))   | Yes | No |
| 39. Is the amount of any deposit of the types listed in checklist item 38 exceeding \$5,000 available for withdrawal no later than the ninth business day following the day of deposit? (§ 229.13(a)(1)(ii))  | Yes | No |

Large Deposits (§ 229.13(b))

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|---|-----|----|
| 40. If the bank invokes the large-deposit rule, does it do so for only that portion of the aggregate local and nonlocal check deposits that exceeds \$5,000 on any one banking day? (§ 229.13(b))   | Yes | No |
| 41. Does the bank refrain from applying this exception to deposits made in cash, to deposits made by electronic payment, or to checks that must receive next-day availability under section 229.10(c)? (See commentary to section 229.13(b).) | Yes | No |
| 42. Does the bank provide customers with a written notice of the longer delay? (§ 229.13(g)(1))   | Yes | No |
| Is the notice (§ 229.13(g)(2))  |     |    |
| A. Provided at the time of the deposit, when the deposit is received in person by an employee of the bank or  | Yes | No |
| B. Mailed on or before the first business day after the day the bank learns of the facts giving rise to the exception   | Yes | No |

Redeposited Checks (§ 229.13(c))

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|--|-----|----|
| 43. Does the bank refrain from applying the redeposited exception to the following?  |     |    |
| A. Checks that are returned because an indorsement is missing and are subsequently indorsed and redeposited (§ 229.13(c)(1))   | Yes | No |
| B. Checks that were returned because they were postdated but are not postdated when redeposited (§ 229.13(c)(2))   | Yes | No |
| 44. Does the bank consider the day the check was redeposited to be the day of deposit when determining when funds must be made available for withdrawal? (commentary to section 229.13(c)) | Yes | No |

### Repeated Overdrafts (§ 229.13(d))

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|---|-----|----|
| 45. Does the bank impose longer holds for depositors who have a history of overdrafts?  | Yes | No |
| 46. Does the bank invoke the repeated-overdraft exception only when the account balance has been negative (or would have been negative had checks or other charges been paid)   |     |    |
| A. Six or more times during the preceding six months or (§ 229.13(d)(1))  | Yes | No |
| B. Two or more times during the preceding six months, if the amount of any negative balance would have been \$5,000 or more (§ 229.13(d)(2))  | Yes | No |
| 47. Is this practice articulated in the bank's written policy and initial disclosure statement? (§ 229.16(a))   | Yes | No |
| 48. When the bank imposes the longer delay, is the depositor notified of the reason, in writing, at the time of deposit? If not, is a notice mailed on or before the first business day after the day of the deposit or the day the bank learns of the facts giving rise to the exception? (§ 229.13(g))              | Yes | No |
| 49. Does the bank return the account to the normal availability schedule when the account is no longer repeatedly overdrawn? (Note: Banks may use this exception for six months after the last overdraft that made the depositor eligible for the repeated-overdraft exception. See checklist item 46.) (§ 229.13(d)) | Yes | No |

### Reasonable Cause to Doubt Collectibility (§ 229.13(e))

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|---|-----|----|
| 50. Does the bank refrain from applying the reasonable-cause exception to the following? (§ 229.13(e)(1))   |     |    |
| A. U.S. Treasury checks   | Yes | No |
| B. U.S. Postal Service money orders   | Yes | No |
| C. State and local government checks  | Yes | No |
| D. On-us checks   | Yes | No |
| 51. When the bank invokes a reasonable-cause exception, does it provide the customer with a written notice of exception at the time the deposit is made, if the deposit is made in person to an employee of the bank? (§ 229.13(g)(1)(ii))                      | Yes | No |
| 52. If the deposit is not made in person to an employee of the bank, or if the hold is placed because of information learned subsequent to the receipt of the deposit, does the institution mail the exception notice to the customer? (§ 229.13(g)(1)(ii))     | Yes | No |
| 53. Does the bank retain a copy of each reasonable-cause exception notice, along with a brief statement of the facts that led to the hold, for a period of two years? (§ 229.13(g)(4))  | Yes | No |
| 54. Does the depository bank refrain from invoking the reasonable-cause exception on the basis of the race or national origin of the depositor or the class of the check? (§ 229.13(e)(1))  | Yes | No |
| 55. Does the bank refrain from assessing a fee for any subsequent overdraft, returned check, or other unpaid charge (or advise customers of their right to a refund of such fees, and refund the fees upon request) if all of the following conditions are met? |     |    |
| A. The depository bank extended the availability period on the basis of its belief that the check was uncollectible (§ 229.13(e)(1))  | Yes | No |
| B. The depositor was not provided with the written notice required by section 229.13(g)(1) at the time of deposit (§ 229.13(e)(2))  | Yes | No |

- |  |     |    |
|--|-----|----|
| C. The overdraft or return would not have occurred if the availability period had not been extended (§ 229.13(e)(2)(i))        | Yes | No |
| D. The deposited check was finally paid by the paying bank (§ 229.13(e)(2)(ii))  | Yes | No |
| 56. Does the exception notice tell the customer where to direct a request for a refund of the overdraft fees? (§ 229.13(e)(2)) | Yes | No |

### Emergency Conditions (§ 229.13(f))

- |   |     |    |
|---|-----|----|
| 57. Does the bank refrain from imposing emergency-condition holds on checks subject to next-day availability under section 229.10(c)? (commentary to § 229.13(f))   | Yes | No |
| 58. Does the bank invoke the emergency-conditions exception only in the following circumstances and when the bank has exercised necessary diligence as circumstances require?   |     |    |
| A. An interruption of communications or computer or other equipment (§ 229.13(f)(1))  | Yes | No |
| B. Suspension of payments by another bank (§ 229.13(f)(2))  | Yes | No |
| C. War (§ 229.13(f)(3))   | Yes | No |
| D. An emergency condition beyond the control of the bank (§ 229.13(f)(4))   | Yes | No |
| 59. Does the bank make funds available for withdrawal no later than a reasonable period after the emergency has ended or within the time period established by the temporary and permanent schedules, whichever is later? (§ 229.13(h)(3)) (As stated in the commentary to section 229.13(h)(4), a reasonable period is five business days for local checks and six for nonlocal checks.) | Yes | No |
| 60. Does the bank provide customers with a written notice of the longer delay? (§ 229.13(g)(1))   | Yes | No |
| 61. Is the notice provided at the time of the deposit, if the deposit is received in person by an employee of the bank, or is the notice mailed on or before the first business day after the day the bank learns of the facts giving rise to the exception? (§ 229.13(g)(1)(ii))   | Yes | No |

### Miscellaneous

#### Calculated Availability—Nonconsumer Transaction Accounts (§ 229.19(d))

- |  |     |    |
|--|-----|----|
| 62. Does the bank calculate funds availability for nonconsumer accounts on the basis of a sample of the customer's deposits? If it does, obtain a copy of the bank's formula for determining its availability schedule. Review a sample of checks similar to that used by the bank to calculate funds availability and answer the following questions: |     |    |
| A. Is the sample of checks large enough to accurately use the formula?   | Yes | No |
| B. Does the formula accurately represent the average composition of the customer's deposits?   | Yes | No |
| C. Does the specified percentage of available funds appear reasonable? (Is a set percentage available the next business day, with remaining funds available according to the customer's deposit mix?)  | Yes | No |
| 63. Based on the sample, are the terms of availability for the account equivalent to or more prompt than the terms outlined in the regulation?   | Yes | No |



## Payment of Interest

Review a copy of the bank's availability schedule for check deposits credited through the Reserve Bank or its correspondent bank. Determine the time that the bank receives provisional credit for check deposits.

64. For each interest-bearing transaction account offered by the bank (for example, NOW accounts and ATS accounts), does the bank begin to accrue interest on the funds deposited no later than the business day on which the bank receives provisional credit for the funds? (§ 229.14)

Yes      No

# Regulation CC

## Workpaper Appendix for Districts with Banks Located outside the Continental U.S.

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For deposits at offices located outside the continental United States, availability may be extended one day under certain strictly defined circumstances and for limited types of deposits. If a check is deposited at a bank office in Alaska, Hawaii, Puerto Rico, or the U.S. Virgin Islands and the paying bank is not located in the same jurisdiction, a one-day extension is permitted for deposits other than those that must be available on the next business day. (Note: This extension applies only to check deposits at bank offices located outside the continental United States. Check deposits received at a bank inside the continental United States but drawn on a bank located outside the continental United States, such as one in Alaska or Hawaii, are not granted an extension.)

- |  |     |    |
|--|-----|----|
| 1. For offices located in Alaska, Hawaii, Puerto Rico, and the U.S. Virgin Islands, does the bank extend availability for check deposits drawn on banks in other states? (§ 229.11(e)(1))  | Yes | No |
| 2. If yes,   |     |    |
| A. Is the extension limited to checks drawn on banks in a different state? (A Hawaiian bank, for example, could receive a "local" check drawn on a bank in Honolulu or a bank in San Francisco. Only the San Francisco check may be delayed.) (§ 229.12(e)(2)) | Yes | No |
| B. Is the extension limited to one day? (§ 229.12(e))  | Yes | No |



# Regulation DD

## Truth in Savings

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### Background

Regulation DD (12 CFR 230), which implements the Truth in Savings Act (TISA), became effective in June 1993. An official staff commentary interprets the requirements of Regulation DD (12 CFR 230 (Supplement I)). Since then, several amendments have been made to Regulation DD and the Staff Commentary, including changes, effective July 1, 2006, to address concerns about the uniformity and adequacy of information provided to consumers when they overdraw their deposit accounts. In addition, beginning October 1, 2008, depository institutions must comply with changes to the rules concerning electronic delivery of disclosures.

The purpose of Regulation DD is to enable consumers to make informed decisions about their accounts at depository institutions through the use of uniform disclosures. The disclosures aid comparison shopping by informing consumers about the fees, annual percentage yield, interest rate, and other terms for deposit accounts. A consumer is entitled to receive disclosures

- When an account is opened;
- Upon request;
- When the terms of the account are changed;
- When a periodic statement is sent; and
- For most time accounts, before the account matures.

The regulation also includes requirements on the payment of interest, the methods of calculating the balance on which interest is paid, the calculation of the annual percentage yield, and advertising.

### Coverage (§230.1)

Regulation DD applies to all depository institutions, except credit unions, that offer deposit accounts to residents of any state. Branches of foreign institutions located in the United States are subject to Regulation DD if they offer deposit accounts to consumers. Edge Act and agreement corporations, and agencies of foreign institutions, are not depository institutions for purposes of Regulation DD.

In addition, persons who advertise accounts are subject to the advertising rules. For example, if a deposit broker places an advertisement offering

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NOTE: This chapter is adapted, with a few minor format, stylistic, and wording changes where appropriate, from the updated Examination Procedures for Regulation DD distributed in July 2008 as an attachment to CA letter 08-3.

consumers an interest in an account at a depository institution, the advertising rules apply to the advertisement, whether the account is to be held by the broker or directly by the consumer.

### Definitions (§230.2)

Section 230.2 defines key terms used in Regulation DD. Among those definitions are the following:

#### Account (§230.2(a))

An *account* is a deposit account at a depository institution that is held by, or offered to, a consumer. It includes time, demand, savings, and negotiable order of withdrawal accounts. Regulation DD covers interest-bearing as well as noninterest-bearing accounts.

#### Advertisement (§230.2(b))

An *advertisement* is a commercial message, appearing in any medium, that promotes directly or indirectly (a) the availability or terms of, or a deposit in, a new account, and (b) for purposes of sections 230.8(a) (misleading or inaccurate advertisements) and 230.11 (additional disclosure requirements for institutions advertising the payment of overdrafts), the terms of, or a deposit in, a new or existing account. An advertisement includes a commercial message in visual, oral, or print media that invites, offers, or otherwise announces generally to prospective customers the availability or terms of, or a deposit in, a consumer account. Examples of advertisements include telephone solicitations and messages on automated teller machine screens.

#### Annual Percentage Yield (§230.2(c))

An *annual percentage yield* is a percentage rate reflecting the total amount of interest paid on an account, based on the interest rate and the frequency of compounding for a 365-day period or 366-day period during leap years and calculated according to the rules in Appendix A of Regulation DD. Interest or other earnings are not to be included in the annual percentage yield if the circumstances for determining the interest and other earnings may or may not occur in the future (see Appendix A, footnote 1).

### Average Daily Balance Method (§230.2(d))

The *average daily balance method* is the application of a periodic rate to the average daily balance in the account for the period. The average daily balance is determined by adding the full amount of principal in the account for each day of the period and dividing that figure by the number of days in the period.

### Board (§230.2(e))

The *Board* means the Board of Governors of the Federal Reserve System.

### Bonus (§230.2(f))

A *bonus* is a premium, gift, award, or other consideration worth more than \$10 (whether in the form of cash, credit, merchandise, or any equivalent) given or offered to a consumer during a year in exchange for opening, maintaining, renewing, or increasing an account balance. The term does not include interest, other consideration worth \$10 or less given during a year, the waiver or reduction of a fee, or the absorption of expenses.

### Business Day (§230.2(g))

A *business day* is a calendar day other than a Saturday, a Sunday, or any of the legal public holidays specified in 5 USC 6103(a).

### Consumer (§230.2(h))

A *consumer* is a natural person who holds an account primarily for personal, family, or household purposes, or to whom such an account is offered. The term does not include accounts held by a natural person on behalf of another in a professional capacity or accounts held by individuals as sole proprietors.

### Daily Balance Method (§230.2(i))

The *daily balance method* is the application of a daily periodic rate to the full amount of principal in the account each day.

### Depository Institution (§230.2(j))

A *depository institution* and an *institution* are institutions defined in section 19(b)(1)(A)(i)-(vi) of the Federal Reserve Act (12 USC 461), except credit unions defined in section 19(b)(1)(A)(iv). Branches of foreign institutions located in the United States are subject to the regulation if they offer deposit accounts to consumers. Edge Act and

agreement corporations, and agencies of foreign institutions, are not depository institutions for purposes of this regulation.

### Deposit Broker (§230.2(k))

A *deposit broker* is a person who is in the business of placing or facilitating the placement of deposits in an institution, as defined by section 29(g) of the Federal Deposit Insurance Act (12 USC 1831f(g))

### Fixed-Rate Account (§230.2(l))

A *fixed-rate account* is an account for which the institution contracts to give at least 30 calendar days' advance written notice of decreases in the interest rate.

### Grace Period (§230.2(m))

A *grace period* is a period following the maturity of an automatically renewing time account during which the consumer may withdraw funds without being assessed a penalty.

### Interest (§230.2(n))

*Interest* is any payment to a consumer or to an account for the use of funds in an account, calculated by applying a periodic rate to the balance. Interest does not include the payment of a bonus or other consideration worth \$10 or less during a year, the waiver or reduction of a fee, or the absorption of expenses.

### Interest Rate (§230.2(o))

An *interest rate* is the annual rate of interest paid on an account and does not reflect compounding. For purposes of the account disclosures in section 230.4(b)(1)(i), the interest rate may, but need not, be referred to as the "annual percentage rate" in addition to being referred to as the "interest rate."

### Passbook Savings Account (§230.2(p))

A *passbook savings account* is a savings account in which the consumer retains a book or other document in which the institution records transactions on the account. Passbook savings accounts include accounts accessed by preauthorized electronic fund transfers to the account. As defined in Regulation E, a preauthorized electronic fund transfer is an electronic fund transfer authorized in advance to recur at substantially regular intervals. Examples include an account that receives direct deposit of Social Security payments. Accounts permitting access by other electronic means are

not passbook savings accounts and must comply with the requirements of section 230.6 if statements are sent four or more times a year.

### Periodic Statement (§230.2(q))

A *periodic statement* is a statement setting forth information about an account (other than a time account or passbook savings account) that is provided to a consumer on a regular basis four or more times a year.

### State (§230.2(r))

A *state* is a state, the District of Columbia, the commonwealth of Puerto Rico, and any territory or possession of the United States.

### Stepped-Rate Account (§230.2(s))

A *stepped-rate account* is an account that has two or more interest rates that take effect in succeeding periods and are known when the account is opened.

### Tiered-Rate Account (§230.2(t))

A *tiered-rate account* is an account that has two or more interest rates that are applicable to specified balance levels. A requirement to maintain a minimum balance to earn interest does not make an account a tiered-rate account.

### Time Account (§230.2(u))

A *time account* is an account with a maturity of at least seven days in which the consumer generally does not have a right to make withdrawals for six days after the account is opened, unless the deposit is subject to an early withdrawal penalty of at least seven days' interest on the amount withdrawn.

### Variable-Rate Account (§230.2(v))

A *variable-rate account* is an account in which the interest rate may change after the account is opened, unless the institution contracts to give at least 30 calendar days' advance written notice of rate decreases.

## General Disclosure Requirements (§230.3)

### General Requirements (§230.3(a) and (b))

Section 230.3 outlines the general requirements for account disclosures and periodic statement disclo-

tures. Such disclosures are required to be

- Clear and conspicuous;
- In writing;
- In a form the consumer may keep;
- Clearly identifiable for different accounts, if disclosures for different accounts are combined;
- Reflective of the terms of the legal obligation of the account agreement between the consumer and the depository institution;
- Available in English upon request if the disclosures are made in languages other than English; and
- Consistent in terminology when describing terms or features that are required to be disclosed.

### Electronic Disclosures

Regulation DD disclosures may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 USC 7001 et seq.).

The E-Sign Act does not mandate that institutions or consumers use or accept electronic records or signatures. It does, however, permit institutions to satisfy any statutory or regulatory requirements that information, such as Regulation DD disclosures, be provided in writing to a consumer by providing the information electronically after obtaining the consumer's affirmative consent. But before consent can be given, consumers must be provided with a clear and conspicuous statement, informing the consumer of

- Any right or option to have the information provided in paper or nonelectronic form;
- The right to withdraw the consent to receive information electronically and the consequences, including fees, of doing so;
- The scope of the consent (for example, whether the consent applies only to a particular transaction or to identified categories of records that may be provided during the course of the parties' relationship);
- The procedures to withdraw consent and to update information needed to contact the consumer electronically; and
- The methods by which a consumer may obtain, upon request, a paper copy of an electronic record after consent has been given to receive the information electronically and whether any fee will be charged.

Prior to consenting, the consumer must be provided with a statement of the hardware and

software requirements for access to, and retention of, the electronic information. The consumer must consent electronically or confirm consent electronically in a manner that “reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent.”

After the consent, if an institution changes the hardware or software requirements such that a consumer may be prevented from accessing and retaining information electronically, the institution must notify the consumer of the new requirements and must allow the consumer to withdraw consent without charge.

The disclosures required by sections 230.4(a)(2) (Disclosures Upon Request) and 230.8 (Advertising) may be provided to the consumer in electronic form without regard to the consumer consent or other provisions of the E-Sign Act, as set forth in those sections of Regulation DD. For example, under section 230.4(a)(2) (Disclosures Upon Request), if a consumer who is not present at the institution makes a request for disclosures, the institution may provide the disclosures electronically if the consumer agrees without regard to the consumer consent or other provisions of the E-Sign Act.

### Relation to Regulation E (§230.3(c))

Disclosures required by and provided in accordance with the Electronic Fund Transfer Act (15 USC 1693 et seq.) and its implementing Regulation E (12 CFR 205) that are also required by Regulation DD may be substituted for the disclosures required by this regulation. Compliance with Regulation E (12 CFR 205) is deemed to satisfy the disclosure requirements of Regulation DD, such as when

- An institution changes a term that triggers a notice under Regulation E, and uses the timing and disclosure rules of Regulation E for sending change-in-term notices;
- Consumers add an ATM access feature to an account, and the institution provides disclosures pursuant to Regulation E, including disclosure of fees (see 12 CFR 205.7);
- An institution, complying with the timing rules of Regulation E, discloses at the same time fees for electronic services (such as for balance inquiry fees at ATMs) required to be disclosed by this regulation but not by Regulation E; or
- An institution relies on Regulation E’s rules regarding disclosure of limitations on the frequency and amount of electronic fund transfers, including security-related exceptions. But any limitations on intra-institutional transfers to or from

the consumer’s other accounts during a given time period must be disclosed, even though intra-institutional transfers are exempt from Regulation E.

### Other Requirements (§230.3(d)—(f))

Other general disclosure requirements include the following:

#### *Multiple Consumers (§230.3(d))*

If an account is held by more than one consumer, disclosures may be made to any one of the consumers.

#### *Oral Response to Inquiries (§230.3(e))*

If an institution chooses to provide rate information orally, it must state the annual percentage yield and may state the interest rate. However, the institution may not state any other rate. The advertising rules do not cover an oral response to a rate inquiry.

#### *Rounding and Accuracy Rules for Rates and Yields (§230.3(f))*

The rounding and accuracy requirements are as follows:

- **Rounding**—The annual percentage yield, the annual percentage yield earned, and the interest rate must be rounded to the nearest one-hundredth of one percentage point (.01 percent) and expressed to two decimal places. (For account disclosures, the interest rate may be expressed to more than two decimal places.) For example, if an annual percentage yield is calculated at 5.644 percent, it must be rounded down and disclosed as 5.64 percent, or if annual percentage yield is calculated at 5.645 percent, it must be rounded up and disclosed as 5.65 percent.
- **Accuracy**—The annual percentage yield (and the annual percentage yield earned) will be considered accurate if it is not more than one-twentieth of one percentage point (.05 percent) above or below the annual percentage yield (and the annual percentage yield earned) that are calculated in accordance with Appendix A of Regulation DD.

### Account Disclosures (§230.4)

Section 230.4 covers the delivery and content of account disclosures both at the time an account is open and when requested by a consumer.

## Delivery of Account Disclosures (§230.4(a))

### *Disclosures at Account Opening (§230.4(a)(1))*

A depository institution must provide account disclosures to a consumer before an account is opened or a service is provided, whichever is earlier. (An institution is deemed to have provided a service when a fee, required to be disclosed, is assessed.) An institution must mail or deliver the account opening disclosures no later than 10 business days after the account is opened or the service is provided, whichever is earlier, if the consumer

- Is not present when the account is opened or the service is provided, and
- Has not received the disclosures.

If a consumer who is not present at the institution uses electronic means (for example, an Internet website) to apply to open an account or to request a service, the disclosures must be provided before the account is opened or the service is provided.

### *Disclosures Upon Request (§230.4(a)(2))*

A depository institution must provide full account disclosures, including complete fee schedules, to a consumer upon request. This requirement pertains to all consumer requests, whether or not the consumer is an existing customer or a prospective customer. A response to an oral inquiry (by telephone or in person) about rates and yields or fees does not trigger the duty to provide account disclosures. However, when consumers ask for written information about an account (whether by telephone, in person, or by other means), the institution must provide disclosures, unless the account is no longer offered to the public.

If the consumer makes the request in person, disclosures must be provided at that time. If a consumer is not present when the request is made, the institution must mail or deliver the disclosures within a reasonable time after it receives the request. Ten business days is considered a reasonable time for responding to requests for account information that a consumer does not make in person, including requests made by electronic means (such as by electronic mail).

If a consumer who is not present at the institution makes a request for account disclosures, including a request made by telephone, e-mail, or via the institution's website, the institution may send the disclosures in paper form, or if the consumer agrees, may provide the disclosures electronically, such as to an e-mail address that the consumer provides for that purpose, or on the institution's

website, without regard to the consumer consent or other provisions of the E-Sign Act. The institution is not required to provide, nor is the consumer required to agree to receive, the disclosures required by section 230.4(a)(2) in electronic form.

When providing disclosures upon the request of a consumer, the institution has several choices of how to specify the interest rate and annual percentage yield. The institution may disclose the rate and yield offered

- Within the most recent seven calendar days,
- As of an identified date, or
- Currently by providing a telephone number for consumers to call.

Further, when providing disclosures upon the request of a consumer, the institution may state the maturity of a time account as a term rather than a date. Describing the maturity of a time account as "1 year" or "6 months," for example, illustrates a statement of the maturity as a term rather than a date ("January 10, 1995").

## Content of Account Disclosures (§230.4(b))

Account disclosures must include, as applicable, information on the following (see Appendix A and B of Regulation DD for information on the annual percentage yield calculation and for model clauses for account disclosures and sample forms):

### *Rate Information (§230.4(b)(1))*

An institution must disclose both the "annual percentage yield" and the "interest rate," using those terms.

For fixed-rate accounts, an institution must disclose the period of time that the interest rate will be in effect.

For variable-rate accounts, an institution must disclose the following:

- The fact that the interest rate and annual percentage yield may change,
- How the interest rate is determined,
- The frequency with which the interest rate may change, and
- Any limitation on the amount the interest rate may change.

### *Compounding and Crediting (§230.4(b)(2))*

An institution must disclose the frequency with which interest is compounded and credited. In cases where consumers will forfeit interest if they close an account before accrued interest is



credited, an institution must state that interest will not be paid.

#### *Balance Information (§230.4(b)(3))*

An institution must disclose the following information about account balances:

- Minimum balance requirements—An institution must disclose any minimum balance requirement to
  - a. Open the account,
  - b. Avoid the imposition of a fee, or
  - c. Obtain the annual percentage yield disclosed.

In addition, the institution must disclose how the balance is determined to avoid the imposition of a fee or to obtain the annual percentage yield.

- Balance-computation method—An explanation of the balance-computation method, specified in section 230.7 of Regulation DD, that is used to calculate interest on the account. An institution may use different methods or periods to calculate minimum balances for purposes of imposing a fee and accruing interest. Each method and corresponding period must be disclosed.
- When interest begins to accrue—An institution must state when interest begins to accrue on noncash deposits.

#### *Fees (§230.4(b)(4))*

An institution must disclose the amount of any fee that may be imposed in connection with the account (or an explanation of how the fee will be determined) and the conditions under which the fee may be imposed. Examples of fees that must be disclosed are

- Maintenance fees, such as monthly service fees;
- Fees to open or to close an account;
- Fees related to deposits or withdrawals, such as fees for use of the institution's ATMs; and
- Fees for special services, such as stop-payment fees.

Institutions must state if fees that may be assessed against an account are tied to other accounts at the institution. For example, if an institution ties the fees payable on a NOW account to balances held in the NOW account and a savings account, the NOW account disclosures must state that fact and explain how the fee is determined.

An institution must specify the categories of transactions for which an overdraft fee may be imposed. For example, it is sufficient to state that

the fee applies to overdrafts "created by check, in-person withdrawal, ATM withdrawal, or other electronic means." However, it is insufficient to state that a fee applies "for overdraft items."

#### *Transaction Limitations (§230.4(b)(5))*

An institution must disclose any limitations on the number or dollar amount of withdrawals or deposits. Examples of such limitations include

- Limits on the number of checks that may be written on an account within a given time period,
- Limits on withdrawals or deposits during the term of a time account, and
- Limits under Regulation D (Reserve Requirements on Depository Institutions) on the number of withdrawals permitted from money market deposit accounts by check to third parties each month.

#### *Features of Time Accounts (§230.4(b)(6))*

For time accounts, an institution must disclose information about the following features:

- Time requirements—An institution must state the maturity date and, for "callable" time accounts, the date or circumstances under which an institution may redeem a time account at the institution's option.
- Early withdrawal penalties—An institution must state
  - a. If a penalty will or may be imposed for early withdrawal,
  - b. How it is calculated, and
  - c. The conditions for its assessment.

An institution may, but does not need to, use the term "penalty" to describe the loss of interest that consumers may incur for early withdrawal of funds from an account.

Examples of early withdrawal penalties include

- a. Monetary penalties, such as "\$10.00" or "seven days' interest plus accrued but uncredited interest";
  - b. Adverse changes to terms such as a lowering of the interest rate, annual percentage yield, or compounding frequency for funds remaining on deposit; and
  - c. Reclamation of bonuses.
- Withdrawal of interest prior to maturity—An institution must disclose the following, as applicable:
    - a. A statement that the annual percentage yield assumes interest remains on deposit until maturity and that a withdrawal will reduce

earnings for accounts where

- i. Compounding occurs during the term, and
  - ii. Interest may be withdrawn prior to maturity, or
- b. A statement that interest cannot remain on deposit and that payout of interest is mandatory for accounts where
- i. The stated maturity is greater than one year,
  - ii. Interest is not compounded on an annual or more frequent basis,
  - iii. Interest is required to be paid out at least annually, and
  - iv. The annual yield is determined in accordance with section E of Appendix A of Regulation DD.
- **Renewal policies**—An institution must state whether an account will, or will not, renew automatically at maturity. If it will, the statement must indicate whether a grace period will be provided and, if so, must indicate the length of that period. For accounts that do not renew automatically, the statement must indicate whether interest will be paid after maturity if the consumer does not renew the account.

#### *Bonuses (§230.4(b)(7))*

For bonuses, an institution must disclose

- The amount or type of any bonus,
- When the bonus will be provided, and
- Any minimum balance and time requirements to obtain the bonus.

#### **Subsequent Disclosures (§230.5)**

Section 230.5 covers the required disclosures when the terms of an account change, resulting in a negative effect on the consumer. In addition, this section covers the required disclosures for both time accounts that automatically renew and have a maturity longer than one month and time accounts that do not renew automatically and have a maturity of longer than one year.

#### **Change in Terms (§230.5(a))**

##### *Advance Notice Required (§230.5(a)(1))*

An institution must give advance notice to affected consumers of any change in a term that is required to be disclosed if the change may reduce the annual percentage yield or adversely affect the consumer. The notice must include the effective

date of the change and must be mailed or delivered at least 30 calendar days before the effective date of the change.

##### *No Notice Required (§230.5(a)(2))*

An institution is not required to provide a notice for the following changes:

- For variable-rate accounts, any change in the interest rate and corresponding changes in the annual percentage yield;
- Any changes in fees assessed for check printing;
- For short-term time accounts, any changes in any term for accounts with maturities of one month or less;
- The imposition of account maintenance or activity fees that previously had been waived for a consumer when the consumer was employed by the depository institution, but who is no longer employed there; and
- The expiration of a one-year period that was part of a promotion, described in the account opening disclosures, for example, to “waive \$4.00 monthly service charges for one year.”

#### **Notice for Time Accounts Longer Than One Month that Renew Automatically (§230.5(b))**

For automatically renewing time accounts with maturity longer than one month, an institution must provide different disclosures depending on whether the maturity is longer than one year or whether the maturity is one year or less. All disclosures must be provided *before* maturity. The requirements are summarized below and in a chart in Attachment A of these procedures.

##### *Maturities Longer Than One Year (§230.5(b)(1))*

If the maturity is longer than one year, the institution must provide the date the existing account matures and the required account disclosures for a new account, as described in section 230.4(b). If the interest rate and annual percentage yield that will be paid for the new account are unknown when disclosures are provided, the institution must state

- That those rates have not yet been determined,
- The date when they will be determined, and
- A telephone number for consumers to call to obtain the interest rate and the annual percentage yield for the new account.

### *Maturities Longer Than One Month but No More Than One Year (§230.5(b)(2))*

If the maturity is longer than one month but less than or equal to one year, the institution must either

- Provide the disclosures required in section 230.5(b)(1) for accounts longer than one year or
- Disclose to the consumer
  - a. The date the existing account matures and the new maturity date if the account is renewed;
  - b. The interest rate and the annual percentage yield for the new account if they are known. If the rates have not yet been determined, the institution must disclose
    - i. The date when they will be determined, and
    - ii. A telephone number the consumer may call to obtain the interest rate and the annual percentage yield for the new account; and
  - c. Any difference in the terms of the new account as compared to the terms required to be disclosed for the existing account.

### *Delivery (§230.5(b))*

All disclosures must be mailed or delivered at least 30 calendar days before maturity of the existing account. Alternatively, the disclosures may be mailed or delivered at least 20 calendar days before the end of the grace period on the existing account, provided a grace period of at least five calendar days is allowed.

### *Notice for Time Accounts Longer Than One Year that Do Not Renew Automatically (§230.5(c))*

For time accounts with maturity longer than one year that do not renew automatically at maturity, an institution must disclose to consumers the maturity date and whether interest will be paid after maturity. The disclosures must be mailed or delivered at least 10 calendar days before maturity of the existing account. The requirements are summarized in a chart in Attachment A of these procedures.

### **Periodic Statement Disclosures (§230.6)**

Regulation DD does not require institutions to provide periodic statements. However, for institutions that mail or deliver periodic statements,

section 230.6 sets forth specific information that must be included in a periodic statement.

### **General Requirements (§230.6(a))**

The statement must include the following disclosures:

#### *Annual Percentage Yield Earned (§230.6(a)(1))*

An institution must state the *annual percentage yield earned* during the statement period, using that term, and calculated according to Appendix A of Regulation DD.

#### *Amount of Interest (§230.6(a)(2))*

An institution must state the dollar amount of interest earned during the statement period, whether or not it was credited. In disclosing interest earned for the period, an institution must use the term “interest” or terminology such as

- “Interest paid” to describe interest that has been credited or
- “Interest accrued” or “interest earned” to indicate that interest is not yet credited.

#### *Fees Imposed (§230.6(a)(3))*

An institution must report any fees that are required to be disclosed and that were debited to the account during the statement period, even if assessed for an earlier period. The fees must be itemized by type and dollar amounts. When fees of the same type are imposed more than once in a statement period, an institution may itemize each fee separately or group the fees together and disclose a total dollar amount for all fees of that type. See Staff Commentary for exceptions. When fees of the same type are grouped together, the description must make clear that the dollar figure represents more than a single fee, for example, “total fees for checks written this period.”

For fees associated with the payment of overdrafts, an institution must separately identify whether the fee was for the payment of an overdraft or for returning the item unpaid, whether or not the institution promotes the payment of overdrafts (see Staff Commentary, section 230.6(a)(3)-2(iv)). In addition, subject to limited exceptions, if the institution promotes the payment of overdrafts, it must provide totals for fees for the payment of overdrafts and for returned items unpaid, both for the statement period and for the calendar year to date. See section 230.11(a)(1) and (2).

*Length of Period (§230.6(a)(4))*

An institution must indicate the total number of days in the statement period, or the beginning and ending dates of the period. Institutions providing the beginning and ending dates of the period must make clear whether both dates are included in the period.

*Combined Statements (Staff Commentary §230.6(a)-3)*

Institutions may provide information about an account (for example, a Money Market Deposit Account) on the periodic statement for another account (such as a Negotiable Order of Withdrawal account) without triggering the disclosures required by this section, as long as

- The information is limited to the account number, the type of account, or balance information, and
- The institution also provides a periodic statement complying with this section for each account.

*Special Rule for Average Daily Balance Method (§230.6(b))*

Section 230.6 has special periodic statement requirements for an institution using the average daily balance method and calculating interest for a period other than the statement period. In these situations, an institution must calculate and disclose the annual percentage yield earned and amount of interest earned based on the time period used rather than the statement period. In addition, when disclosing the length of period requirement on the periodic statement, an institution must state this information for the statement period as well as the interest-calculation period. See Staff Commentary for examples.

*Payment of Interest (§230.7)*

Section 230.7 covers the payment of interest, including how to determine the balance on which to pay interest, the daily periodic rate to use, and the date interest begins to accrue.

*Permissible Methods to Determine Balance to Calculate Interest (§230.7(a)(1))*

An institution must calculate interest on the full amount of principal in an account for each day by using one of the two following methods:

- Daily balance method, where the daily periodic rate is applied to the full amount of principal in the account each day, or
- Average daily balance method, where a periodic

rate is applied to the average daily balance in the account for the period. The average daily balance is determined by adding the full amount of principal in the account for each day of the period and dividing that figure by the number of days in the period.

The following are prohibited calculation methods:

- Ending-balance method, where interest is paid on the balance in the account at the end of the period;
- Low-balance method, where interest is paid based on the lowest balance in the account for any day in that period; and
- Investable-balance method, where interest is paid on a percentage of the balance, excluding the amount set aside for reserve requirements.

*Use of 365-Day Basis (Staff Commentary §230.7(a)(1)-2)*

Institutions may apply a daily periodic rate greater than 1/365 of the interest rate—such as 1/360 of the interest rate—as long as it is applied 365 days a year.

*Leap Year (Staff Commentary §230.7(a)(1)-4)*

Institutions may apply a daily rate of 1/366 or 1/365 of the interest rate for 366 days in a leap year, if the account will earn interest for February 29.

*Maturity of Time Accounts (Staff Commentary §230.7(a)(1)-5)*

Institutions are not required to pay interest after time accounts mature.

*Dormant Accounts (Staff Commentary §230.7(a)(1)-6)*

Institutions must pay interest on funds in an account, even if inactivity or the infrequency of transactions would permit the institution to consider the account to be “inactive” or “dormant” (or similar status) as defined by state, other laws, or the account contract.

*Permissible Methods to Determine Minimum Balance to Earn Interest (§230.7(a)(2))*

If an institution requires a minimum balance to earn interest, it must use the same method to determine the required minimum balance as it uses to determine the balance on which interest is calculated. For example, if an institution requires a \$300 minimum balance that would be determined by

using the average daily balance method, then it must calculate interest based on the average daily balance method. Further, an institution may use an additional method that is unequivocally beneficial to the consumer.

#### *Balances Below the Minimum (Staff Commentary §230.7(a)(2)-1 and 2)*

An institution that requires a minimum balance may choose not to pay interest for days or period when the balance drops below the required minimum, whether they use the daily balance method or the average daily balance method to calculate interest.

#### *Paying on Full Balance (Staff Commentary §230.7(a)(2)-4)*

Institutions must pay interest on the full balance in the account that meets the required minimum balance. For example, if \$300 is the minimum daily balance required to earn interest, and a consumer deposits \$500, the institution must pay the stated interest rate on the full \$500 and not just on \$200.

#### *Minimum Balance Not Affecting Interest (Staff Commentary §230.7(a)(2)-7)*

Institutions may use the daily balance, average daily balance, or any other computation method to calculate minimum balance requirements that do not involve the payment of interest. For example, an institution may use any computation method to compute minimum balances for assessing fees.

#### **Compounding and Crediting Policies (§230.7(b))**

This section does not require institutions to compound or credit interest at any particular frequency. Institutions choosing to compound interest may compound or credit interest annually, semi-annually, quarterly, monthly, daily, continuously, or on any other basis.

An institution may choose not to pay accrued interest if consumers close an account prior to the date accrued interest is credited, as long as the institution has disclosed this practice in the initial account disclosures.

#### **Date Interest Begins to Accrue (§230.7(c))**

Interest shall begin to accrue not later than the business day specified for interest-bearing accounts in section 606 of the Expedited Funds Availability Act, which states

... interest shall accrue on funds deposited in

an interest-bearing account at a depository institution beginning not later than the business day on which the depository institution receives provisional credit for such funds.

Interest shall accrue until the day funds are withdrawn.

#### **Advertising (§230.8)**

Section 230.8 contains account advertising requirements, including overall general rules and rules for special account features. In addition, the section describes advertising involving certain types of media and in-house posters that are exempt from Regulation DD's advertising requirements.

#### **General Advertising Rules (§230.8(a) and (b))**

##### *Misleading or Inaccurate Advertising (§230.8(a))*

An institution may not advertise in a way that is misleading or inaccurate or misrepresents its deposit contract. In addition, an advertisement may not use the word "profit" in referring to interest paid on an account.

An institution's advertisement may not refer to or describe an account as "free" or "no cost" (or contain a similar term such as "fees waived") if a maintenance or activity fee may be imposed on the account. Examples of such maintenance or activity fees include

- Any fee imposed when a minimum balance requirement is not met, or when consumers exceed a specified number of transactions;
- Transaction and service fees that consumers reasonably expect to be imposed on a regular basis;
- A flat fee, such as a monthly service fee; and
- Fees imposed to deposit, withdraw, or transfer funds, including per-check or per-transaction charges (for example, 25 cents for each withdrawal, whether by check or in person).

Examples of fees that are not maintenance or activity fees include

- Fees not required to be disclosed under section 230.4(b)(4),
- Check-printing fees,
- Balance-inquiry fees,
- Stop-payment fees and fees associated with checks returned unpaid,
- Fees assessed against a dormant account, and
- Fees for ATM or electronic transfer services

(such as preauthorized transfers or home banking services) not required to obtain an account.

If an account (or a specific account service) is free only for a limited period of time (for example, for one year following the account opening) the account (or service) may be advertised as free if the time period is also stated.

If an electronic advertisement (such as an advertisement appearing on an Internet website) displays a triggering term (such as a bonus or annual percentage yield), described elsewhere in section 230.8, the advertisement must clearly refer the consumer to the location where the additional required information begins. For example, an advertisement that includes a bonus or annual percentage yield may be accompanied by a link that directly takes the consumer to the additional information. As discussed in section 230.3(a), electronic advertising disclosures may be provided to the consumer in electronic form without regard to the consumer consent or other provisions of the E-Sign Act.

The Staff Commentary provides the following examples of advertisements that would ordinarily be misleading, inaccurate, or misrepresent the deposit contract:

- Representing an overdraft service as a “line of credit,” unless the service is subject to the Board’s Regulation Z, 12 CFR 226.
- Representing that the institution will honor all checks or authorize payment of all transactions that overdraw an account, with or without a specified dollar limit, when the institution retains discretion at any time not to honor checks or authorize transactions.
- Representing that consumers with an overdrawn account are allowed to maintain a negative balance when the terms of the account’s overdraft service require consumers promptly to return the deposit account to a positive balance.
- Describing an institution’s overdraft service solely as protection against bounced checks when the institution also permits overdrafts for a fee for overdrawing accounts by other means, such as ATM withdrawals, debit card transactions, or other electronic fund transfers.
- Advertising an account-related service for which the institution charges a fee in an advertisement that also uses the word “free” or “no cost” (or a similar term) to describe the account, unless the advertisement clearly and conspicuously indicates that there is a cost associated with the service. If the fee is a maintenance or activity fee under section 230.8(a)(2) of this part, however, an advertisement may not describe the account as “free” or “no cost” (or contain a similar term)

even if the fee is disclosed in the advertisement.

#### *Advertising Rate Information (§230.8(b))*

When an institution states a rate of return in an advertisement,

- It must state the rate as an “annual percentage yield,” using that term;
- If the advertisement uses the abbreviation “APY,” the term “annual percentage yield” must be stated at least once in the advertisement;
- If the advertisement uses the term “interest rate,” it must use the term in conjunction with, but not more conspicuously than, the related annual percentage yield; and
- It must round the annual percentage yield, the annual percentage yield earned, and the interest rate to the nearest one-hundredth of one percentage point (.01 percent) and express them to two decimal places.

An advertisement for a tiered-rate account that states an annual percentage yield must also state the annual percentage yield for each tier, along with corresponding minimum balance requirements.

An advertisement for a stepped-rate account that states an interest rate must state all the interest rates and the time period that each rate is in effect.

#### *Required Advertising for Special Account Features (§230.8(c))*

If an institution advertises an annual percentage yield for a product and the product includes one of the features listed in sections 230.8(c)(1)-(6), then the institution must clearly and conspicuously disclose the information outlined in sections 230.8(c)(1)-(6) as noted below. However, these requirements do not necessarily apply if the situation falls under the exemptions of section 230.8(e).

##### *Variable Rates (§230.8(c)(1))*

For variable-rate accounts, the advertisement must state that the rate may change after the account is opened.

##### *Time Annual Percentage Yield (APY) Is Offered (§230.8(c)(2))*

The advertisement must include the period of time during which the annual percentage yield will be offered. Alternatively, the advertisement may state that the annual percentage yield is accurate as of a specified date. The date must be recent in relation to the publication or media broadcast used for the

advertisement, taking into account the particular circumstances or production deadlines involved. An advertisement may refer to the annual percentage yield as being accurate as of the date of publication, if the date is on the publication itself.

#### *Minimum Balance (§230.8(c)(3))*

For accounts that have a required minimum balance, the advertisement must state the minimum balance required to obtain the advertised annual percentage yield. For tiered-rate accounts, the advertisement must state the minimum balance required for each tier in close proximity and, with equal prominence to, the applicable annual percentage yield.

#### *Minimum Opening Deposit (§230.8(c)(4))*

For an account that requires a minimum deposit to open the account, the advertisement must state the minimum deposit required to open the account, if it is greater than the minimum balance necessary to obtain the advertised annual percentage yield.

#### *Effect of Fees (§230.8(c)(5))*

An advertisement must state that fees could reduce the earnings on the account. This requirement only applies to maintenance or activity fees.

#### *Features of Time Accounts (§230.8(c)(6))*

For time accounts, the advertisement must include

- Term of the account;
- Early withdrawal penalties—a statement that a penalty will or may be imposed for early withdrawal; and
- Required interest payouts—a statement that interest cannot remain on deposit and that payout of interest is mandatory for noncompounding time accounts with the following features:
  - a. The stated maturity is greater than one year,
  - b. Interest is not compounded on an annual or more frequent basis,
  - c. Interest is required to be paid out at least annually, and
  - d. The annual percentage yield is determined in accordance with section E of Appendix A of Regulation DD.

#### **Bonuses (§230.8(d))**

If an institution states a bonus in an advertisement, the advertisement must state clearly and conspicuously

the following information, if applicable to the advertised product:

- “Annual percentage yield,” using that term;
- Time requirement to obtain the bonus;
- Minimum balance required to obtain the bonus;
- Minimum balance required to open the account, if it is greater than the minimum balance necessary to obtain the bonus; and
- Time when the bonus will be provided.

However, these requirements do not necessarily apply if the situation falls under the exemptions of section 230.8(e). In addition, general statements such as “bonus checking” or “get a bonus when you open a checking account” do not trigger the bonus disclosures.

#### **Exemption for Certain Advertisements (§230.8(e))**

Section 230.8(e) exempts certain types of media and certain indoor signs from some of the section’s advertising rules.

#### *Media Exemptions (§230.8(e)(1))*

If an institution advertises through one of the following media, the advertisement does not need to include information required under certain section 230.8 rules, as outlined below:

- Exempted Media—
  - a. Broadcast or electronic media, such as television or radio. However, the exemption does not extend to Internet and e-mail advertisements.
  - b. Outdoor media, such as billboards.
  - c. Telephone response machines. However, solicitations for a tiered-rate account made through telephone-response machines must provide the annual percentage yields and the balance requirements applicable to each tier.
- Exempted Advertising Requirements—
  - a. Information required for special account features involving variable rates, time an annual percentage yield is offered, minimum opening deposit, effect of fees, and early withdrawal penalties for time accounts.
  - b. When bonuses are advertised, information required related to a minimum balance to open an account (if it is greater than the minimum balance necessary to obtain the bonus) and related to when a time the bonus will be provided.

*Indoor Signs (§230.8(e)(2))*

If an institution posts account information on signs inside its premises (or the premises of a deposit broker), the postings are exempt from the advertising requirements for

- Permissible rates,
- When additional disclosures are required,
- Bonuses, and
- Certain media exemption.

If a sign, falling under this exemption, states a rate of return, it must

- State the rate as an “annual percentage yield,” using that term or the term “APY.” The sign must not state any other rate, although the related interest rate may be stated.
- Contain a statement advising consumers to contact an employee for further information about applicable fees and terms.

Indoor signs include advertisements displayed on computer screens, banners, preprinted posters, and chalk or peg boards. Any advertisement inside the premises that can be retained by a consumer (such as a brochure or a printout from a computer) is not an indoor sign.

*Additional Disclosures in Connection with the Payment of Overdrafts (§230.8(f))*

An institution that promotes the payment of overdrafts in an advertisement must also include in the advertisement the disclosures required under section 230.11(b).

*Record Retention (§230.9(c))*

Section 230.9(c) covers the record retention requirements in order for an institution to demonstrate compliance with Regulation DD, including rate information, advertising, and providing disclosures to consumers at the appropriate time (including upon a consumer’s request).

*Timing*

An institution must retain records that evidence compliance for a minimum of two years after the date that disclosures are required to be made or an action is required to be taken. If required by its supervising agency, an institution may need to retain records for a longer time period.

*Evidence of Required Actions*

An institution may demonstrate its compliance by

- Establishing and maintaining procedures for paying interest and providing timely disclosures, and
- Retaining sample disclosures for each type of account offered to consumers such as account-opening disclosures, copies of advertisements, and change-in-term notices; and information regarding the interest rates and annual percentage yields offered.

*Methods of Retaining Evidence*

An institution must be able to reconstruct the required disclosures and other required actions, but does not need to maintain hard copies of disclosures and other records. It may keep records evidencing compliance in microfilm, microfiche, or other methods that reproduce records accurately (including computer files).

*Payment of Interest*

An institution must retain sufficient rate and balance information to permit the verification of interest paid on an account, including the payment of interest on the full principal balance.

**Section 230.10—[Reserved]****Disclosures for Institutions Advertising the Payment of Overdrafts (§230.11)**

Section 230.11 contains periodic statement and advertising requirements for overdraft protection products. The requirements address concerns about the uniformity and adequacy of information provided to consumers when they overdraw their deposit accounts. Specifically, they address certain types of services—sometimes referred to as “bounced-check protection” or “courtesy overdraft protection”—which institutions offer to pay consumers’ checks, and which allow other overdrafts when there are insufficient funds in the account.

*Periodic Statement Disclosures (§230.11(a))**Disclosure of Total Fees (§230.11(a)(1))*

Unless covered by an exception under section 230.11(a)(2), if an institution promotes the payment of overdrafts in an advertisement, the institution must disclose on its periodic statements (if it provides periodic statements) separate totals for the statement period and for the calendar year to date for

- The total dollar amount for all fees or charges imposed on the account for paying checks or



other items when there are insufficient funds and the account becomes overdrawn, and

- The total dollar amount for all fees imposed on the account for returning items unpaid.

The total dollar amount for paying overdrafts includes per-item fees as well as interest charges, daily or other periodic fees, or fees charged for maintaining an account in overdraft status, whether the overdraft is by check or by other means. It also includes fees charged when there are insufficient funds because previously deposited funds are subject to a hold or are uncollected. It does not include fees for transferring funds from another account to avoid an overdraft, or fees charged when the institution has previously agreed in writing to pay items that overdraw the account and the service is subject to Regulation Z, 12 CFR 226.

If an advertisement that promotes the payment of overdrafts does not specify the types of accounts to which it applies, the advertisement would be considered to apply to all of an institution's deposit accounts. In that circumstance, the periodic statement disclosure requirements would apply to all deposit accounts.

An institution would trigger the periodic statement disclosures if it

- Promotes the institution's policy or practice of paying some overdrafts (unless the service would be subject to the Board's Regulation Z (12 CFR 226)), in advertisements using broadcast media, brochures, telephone solicitations or electronic mail, or on Internet sites, ATM screens or receipts, billboards, or indoor signs (see section 230.11(a)(2) regarding communications about the payment of overdrafts that would not trigger periodic statement disclosures.);
- Includes a message on a periodic statement informing the consumer of an overdraft limit or the amount of funds available for overdrafts. For example, an institution that includes a message on a periodic statement informing the consumer of a \$500 overdraft limit or that the consumer has \$300 remaining on the overdraft limit, is promoting an overdraft service; or
- Discloses an overdraft limit or includes the dollar amount of an overdraft limit in a balance disclosed by any means, including on an ATM receipt or on an automated system, such as a telephone response machine, ATM screen, or the institution's Internet site.

#### *Communications Exempted from the Disclosure of Total Fees (§230.11(a)(2))*

The following communications by an institution do not trigger the required disclosures for total fees:

- Promoting in an advertisement a service for paying overdrafts where the institution's payment of overdrafts would be agreed upon in writing and subject to Regulation Z (12 CFR 226);
- Communicating (whether by telephone, electronically, or otherwise) about the payment of overdrafts in response to a consumer-initiated inquiry about deposit accounts or overdrafts. However, providing information about the payment of overdrafts in response to a balance inquiry made through an automated system, such as a telephone response machine, an automated teller machine (ATM), or an institution's Internet site, is not a response to a consumer-initiated inquiry that is exempt from the disclosure requirement;
- Engaging in an in-person discussion with a consumer;
- Making disclosures that are required by federal or other applicable law;
- Providing a notice or including information on a periodic statement informing a consumer about a specific overdrawn item or the amount the account is overdrawn;
- Including in a deposit account agreement a discussion of the institution's right to pay overdrafts;
- Providing a notice to a consumer, such as at an ATM, that completing a requested transaction may trigger a fee for overdrawing an account, or providing a general notice that items overdrawing an account may trigger a fee; and
- Providing informational or educational materials concerning the payment of overdrafts if the materials do not specifically describe the institution's overdraft service.

#### *Time Period Covered by Disclosures (§230.11(a)(3))*

An institution must make the total fee disclosures for the first statement period that begins after an institution advertises the payment of overdrafts. An institution may disclose total fees imposed for the calendar year by aggregating fees imposed since the beginning of the calendar year, or since the beginning of the first statement period for the year for which such disclosures are required.

#### *Termination of Promotion (§230.11(a)(4))*

The requirement to disclose total fees for paying an overdraft and for returning checks unpaid on a deposit account ceases two years after the date of an institution's last advertisement promoting the payment of overdrafts applicable to the deposit account.

*Acquired Accounts (§230.11(a)(5))*

An institution that acquires an account must provide the periodic statement disclosures for the first statement period that begins after the institution advertises the payment of overdrafts for the acquired account. If disclosures are required for the acquired account, the institution may, but is not required to, include fees imposed prior to acquisition of the account.

*Advertising Disclosures for Overdraft Services (§230.11(b))**Disclosures (§230.11(b)(1))*

Unless an exception in section 230.11(b)(2)-(4) applies, any advertisement promoting the payment of overdrafts must disclose in a clear and conspicuous manner all of the following:

- The fee(s) for the payment of each overdraft,
- The categories of transactions for which a fee may be imposed for paying an overdraft,
- The time period by which the consumer must repay or cover any overdraft, and
- The circumstances under which the institution will not pay an overdraft. It is sufficient to state, as applicable, “Whether your overdrafts will be paid is discretionary and we reserve the right not to pay. For example, we typically do not pay overdrafts if your account is not in good standing, or you are not making regular deposits, or you have too many overdrafts.”

*Communications Not Subject to Additional Advertising Disclosures (§230.11(b)(2))*

The advertising disclosure rules for overdraft services do not apply in the following circumstances:

- An advertisement promoting a service where the institution’s payment of overdrafts would be agreed upon in writing and subject to Regulation Z (12 CFR 226).
- A communication by an institution about the payment of overdrafts in response to a consumer-initiated inquiry about deposit accounts or overdrafts. However, providing information about the payment of overdrafts in response to a balance inquiry made through an automated system, such as a telephone response machine, ATM, or an institution’s Internet site, is not a response to a consumer-initiated inquiry that is exempt from the advertising disclosures.
- An advertisement made through broadcast or electronic media, such as television or radio. However, this exception does not apply to

advertisements posted on an institution’s Internet site, on an ATM screen, provided on telephone-response machines, or sent by electronic mail.

- An advertisement made on outdoor media, such as billboards.
- An ATM receipt.
- An in-person discussion with a consumer.
- Disclosures required by federal or other applicable law.
- Information included on a periodic statement or on a notice informing a consumer about a specific overdrawn item or the amount the account is overdrawn.
- A term in a deposit account agreement discussing the institution’s right to pay overdrafts.
- A notice provided to a consumer, such as at an ATM, that completing a requested transaction may trigger a fee for overdrawing an account, or a general notice that items overdrawing an account may trigger a fee.
- Informational or educational materials concerning the payment of overdrafts if the materials do not specifically describe the institution’s overdraft service.

*Exception for ATM Screens and Telephone Response Machines (§230.11(b)(3))*

Any advertisement made on an ATM screen or using a telephone response machine is not required to include the following:

- The categories of transactions for which a fee may be imposed for paying an overdraft or
- The circumstances under which the institution will not pay an overdraft.

*Exception for Indoor Signs (§230.11(b)(4))*

The advertising requirement to disclose fees for the payment of each overdraft does not apply to advertisements for the payment of overdrafts on indoor signs, if the indoor sign contains a clear and conspicuous statement that

- Fees may apply and
- Consumers should contact an employee for further information about applicable fees and terms.

An indoor sign covered under this exception is one described in section 230.8(e)(2) and the accompanying Staff Commentary. In addition to the Staff Commentary’s examples of advertisements that are not considered indoor signs, an ATM screen is not considered an indoor sign for purposes of the overdraft disclosure requirements.

**Effect on State Laws  
(Regulation DD—Appendix C)**

Regulation DD preempts state law requirements that are inconsistent with the requirements of the Truth in Savings Act (TISA) or Regulation DD. A

state law is inconsistent if it contradicts the definitions, disclosure requirements, or interest-calculation methods outlined in the act or the regulation. The regulation also provides that interested parties may request the Board to determine whether a state law is inconsistent with the TISA.

**Attachment A—Subsequent Notice Requirements for Time Accounts**

Maturity	Automatically renewable (rollover)	Non-automatically renewable (non-rollover)
More than 1 month and more than 1 year	<p><i>Timing</i></p> <p>(a) 30 calendar days before maturity,</p> <p>or</p> <p>(b) 20 calendar days before end of grace period, if a grace period is at least 5 calendar days</p> <p><i>Content</i></p> <p>(a) Date existing account matures</p> <p>(b) Disclosures for a new account (§ 230.4(b))</p> <p>If terms have not been determined, indicate this fact and state when they will be determined or provide a telephone number to obtain the terms.</p> <p>(§ 230.5(b)(1))</p>	<p><i>Timing</i></p> <p>10 calendar days before maturity</p> <p><i>Content</i></p> <p>Maturity date, and whether or not interest will be paid after maturity</p> <p>(§ 230.5(c))</p>
More than 1 month and less than 1 year	<p><i>Timing</i></p> <p>(a) 30 calendar days before maturity,</p> <p>or</p> <p>(b) 20 calendar days before end of grace period, if a grace period is at least 5 calendar days</p> <p><i>Content</i></p> <p>(a) Disclosures required under § 230.5(b)(1),</p> <p>or</p> <p>(b) Date of maturities of existing and new account, any change in terms, and a difference in terms between new account and ones of existing account.</p> <p>If terms have not been determined, indicate this fact and state when they will be determined or provide a telephone number to obtain the terms.</p> <p>(§ 230.5(b)(2))</p>	No subsequent notice required

# Regulation DD

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

1. To determine the institution's compliance with Regulation DD, including the requirements to provide full account disclosures (for example, fee schedules) to consumers upon request and the requirements covering overdraft payment disclosures and advertising.
  2. To assess the quality of the institution's compliance risk-management systems and its policies and procedures for implementing Regulation DD.
  3. To determine the reliance that can be placed on the institution's internal controls and procedures for monitoring the institution's compliance with Regulation DD.
  4. To direct corrective action when violations of law are identified, or when the institution's policies or internal controls are deficient.
- f. The frequency of review is appropriate.
  3. Through discussions with management and review of available information, determine whether the institution's internal controls are adequate to ensure compliance with the Regulation DD area under review. Consider the following:
    - a. Organization charts
    - b. Process flowcharts
    - c. Policies and procedures
    - d. Account documentation
    - e. Checklists
    - f. Computer program documentation
  4. Through a review of the institution's training materials, determine whether
    - a. The institution provides appropriate training to individuals responsible for Regulation DD compliance and operational procedures.
    - b. The training is comprehensive and covers the various aspects of Regulation DD that apply to the individual institution's product offerings and operations.
    - c. The training includes the timing requirements of section 230.4(a)(2) to provide disclosure information (for example, terms, conditions, and fees) to a consumer upon a request, whether or not the consumer is an existing or a prospective customer. Review whether the training instructs all employees, including branch employees, to provide such disclosures at the time of the request if the consumer makes the request in person or within 10 business days if the consumer is not present when making the request.

### EXAMINATION PROCEDURES

#### Management and Policy-Related Examination Procedures

1. Determine the types of deposit accounts offered by the institution to consumers (including accounts usually offered to commercial customers that may occasionally be offered to consumers) as well as the characteristics of each type of deposit account (for example, bonuses offered, minimum balances, balance-computation method, frequency of interest crediting, fixed or variable rates, fees imposed, and frequency of periodic statements).
2. Review all written policies and procedures, management's self-assessments, consumer complaints, and any compliance audit material including work papers and reports to determine whether
  - a. The scope of the audit addresses all provisions as applicable.
  - b. Management has taken corrective actions to follow up on previously identified deficiencies.
  - c. The testing includes samples covering all product types and decision centers.
  - d. The work performed is accurate.
  - e. Significant deficiencies and their causes are included in reports to management and/or to the board of directors.
5. Determine the extent and adequacy of the institution's policies, procedures, and practices for ensuring compliance with the regulation. In particular, verify that
  - a. Account disclosure information is available to be provided to all consumers within the appropriate time frames. This requirement pertains to all consumer requesters whether or not the consumer is an existing customer or a prospective customer.
  - b. Advance notice is given for any changes in terms required to be disclosed under section 230.4 and that exceptions to the advance notice requirements are limited to those set forth in section 230.5(a)(2).

- c. If periodic statements are given, the statements disclose the required information, including the annual percentage yield earned, the amount of interest, fees imposed, and the statement's covered time period.
- d. The institution's methods of paying interest are permissible. Review the dates on which interest begins to accrue on deposits to accounts, and determine whether hold times comply with the Expedited Funds Availability Act.
- e. The institution's advertising policies are consistent with the requirements of the regulation.
- f. Evidence of compliance is retained for a minimum of two years after the date disclosures are required to be made or action is required to be taken.
- g. If the payment of overdrafts is promoted in an advertisement, the periodic statements include the disclosure of total fees. In addition, verify compliance with the advertising disclosure requirements for overdraft services.

## Transaction-Related Examination Procedures

If upon conclusion of the management and policy-related examination procedures, procedural weaknesses or other risks requiring further investigation are noted, conduct the transaction testing, as necessary, using the following examination procedures. Use examiner judgment in deciding how large each sample of deposit account disclosures, notices, and advertisements should be. The sample size should be increased until confidence is achieved that all aspects of the institution's activities and policies that are subject to the regulation are reviewed.

## General Disclosure Requirements (12 CFR 230.3)

1. Determine whether disclosures are made clearly and conspicuously in writing and in a form the consumer may keep. (§230.3(a))
2. If the disclosures are combined with other account disclosures, determine whether it is clear which disclosures are applicable to the consumer's account. (§230.3(a))
3. If the institution provides consumer disclosures in electronic form, determine whether the institution has obtained the consumer's consent, where required, and complies with the other applicable provisions of the Electronic Signatures in Global and National Commerce

Act (E-Sign Act) (15 USC 7001 et seq.). (§230.3(a))

4. Determine whether the disclosures reflect the legal obligation of the account agreement between the consumer and the institution. (§230.3(b))
5. If disclosures are provided in a language other than English, verify whether the disclosures are available in English upon request. (§230.3(b))
6. Determine whether disclosures use consistent terminology when describing terms or features that are required to be disclosed. (Staff Commentary 230.3(a)-2)
7. Determine whether the institution substitutes disclosures required by Regulation E for disclosures required by Regulation DD. (§230.3(c))
8. Determine whether the institution provides required disclosures to at least one account holder if there are multiple holders. (§230.3(d))
9. Determine whether the institution's oral response to a consumer's inquiry about interest rates payable on accounts state the annual percentage yield (APY). If the institution chooses, it may also state the interest rate, but no other rate. (§230.3(e))
10. Determine whether the APY, the annual percentage yield earned (APYE), and the interest rate are rounded to the nearest one-hundredth of one percentage point (.01 percent).  
NOTE: For account disclosures, the interest rate may be expressed to more than two decimal places. (§230.3(f)(1))
11. Determine whether the APYs and APYEs are not more than one-twentieth of one percentage point (.05 percent) above or below the APY (and APYE) as determined in accordance with Appendix A of Regulation DD. (§230.3(f)(2))

## Account Disclosures (12 CFR 230.4)

### Delivery of Account Disclosures

#### *Account Opening*

1. Determine whether account disclosures are provided to consumers before an account is opened or a service is provided, whichever is earlier. (§230.4(a)(1)(i))
  - a. If the consumer is not present when the account is opened or a service is provided (and has not already received the disclosures), the disclosures should be mailed or delivered no later than 10 business days after the account is opened or the service is provided, whichever is earlier. (§230.4(a)(1)(i))

- b. If the consumer who is not present at the institution uses electronic means to open an account or request a service, the disclosures must be provided before the account is opened or the service is provided. (§230.4(a)(1)(ii))

### *Consumer Request*

2. Determine whether full account disclosures, including complete fee schedules, are available to be provided to a consumer upon request. This requirement pertains to all consumer requests, whether or not the consumer is an existing customer or a prospective customer.
  - a. If the request is made in person, determine whether the disclosures are available to be provided upon request.
  - b. If the consumer is not present, the institution must mail or deliver the disclosures within a reasonable period of time after it receives the request (generally no more than 10 days). (§230.4(a)(2)(i))
3. Determine whether the institution chooses one of the following options when providing rate information: (§230.4(a)(2)(ii)(A))
  - a. Specifies an interest rate and APY that were offered within the most recent seven calendar days,
  - b. States that the rate and yield are accurate as of an identified date, or
  - c. Provides a telephone number that consumers may call to obtain current rate information.
4. For a time deposit account, the institution may state the maturity as a term rather than a date. (§230.4(a)(2)(ii)(B))

### *Content of Disclosures*

#### *Rate Information*

5. Determine whether account disclosures include, as applicable,
  - a. The “annual percentage yield” and the “interest rate” using those terms, and
  - b. For fixed-rate accounts the period of time the interest rate will be in effect. (§230.4(b)(1)(i))
6. For variable-rate accounts, determine whether account disclosures include the following information: (§230.4(b)(1)(ii))
  - a. The fact that the interest rate and APY may change,
  - b. How the interest rate is determined,

- c. The frequency with which the interest rate may change, and
- d. Any limitations on the amount the interest rate may change.

#### *Compounding and Crediting*

7. Determine whether account disclosures describe the frequency with which interest is compounded or credited. (§230.4(b)(2)(i))
8. If the consumer will forfeit interest if the consumer closes an account before accrued interest is credited, determine whether account disclosures include a statement that interest will not be paid in such cases. (§230.4(b)(2)(ii))

#### *Balance Information*

9. As applicable, determine whether account disclosures
  - a. Describe the minimum balance required to (§230.4(b)(3)(i))
    - i. Open an account,
    - ii. Avoid the imposition of a fee, or
    - iii. Obtain the APY disclosed.
  - b. Describe how the minimum balance requirement is determined to avoid the imposition of a fee or to obtain the APY disclosed. (§230.4(b)(3)(i))
  - c. Explain the balance computation method (specified in section 230.7) used to calculate interest on the account. (§230.4(b)(3)(ii))
  - d. State when interest begins to accrue on noncash deposits (§230.4(b)(3)(iii))

#### *Fees*

10. Determine whether account disclosures state the amount of any fee that may be imposed in connection with the account (or an explanation of how the fee will be determined) and the conditions under which the fee may be imposed. (§230.4(b)(4))
  - a. Regardless of whether the institution promotes overdraft payment, determine whether the institution has specified the categories of transactions for which an overdraft fee may be imposed. (Staff Commentary §230.4(b)(4)-5)

#### *Transaction Limitations*

11. Determine whether the account disclosures state any limits on the number or dollar amount of withdrawals or deposits. (§230.4(b)(5))

#### *Features of Time Accounts*

12. For time accounts, determine whether account disclosures include, as applicable,

- a. The maturity date. (§230.4(b)(6)(i))
- b. A statement that a penalty will or may be imposed for early withdrawal, how it is calculated, and the conditions for its assessment. (§230.4(b)(6)(ii))
- c. If compounding occurs during the term and the interest may be withdrawn prior to maturity, a statement that the APY assumes interest remains on deposit until maturity and that a withdrawal will reduce earnings. (§230.4(b)(6)(iii))
- d. A statement that interest cannot remain on deposit and that payout of interest is mandatory for accounts (§230.4(b)(6)(iii))
  - i. With a stated maturity greater than one year,
  - ii. That do not compound interest on an annual or more frequent basis,
  - iii. That require interest payouts at least annually, and
  - iv. That disclose an APY determined in accordance with section E of Appendix A of Regulation DD.
- e. A statement of whether or not the account will renew automatically at maturity. (§230.4(b)(6)(iv))
  - i. If it will renew automatically at maturity, a statement whether or not a grace period will be provided and, if so, the length of the grace period.
  - ii. If it will not renew automatically, a statement of whether interest will be paid after maturity if the consumer does not renew the account.
- b. Is mailed or delivered at least 30 days before the effective date of the change.
- 2. Determine whether exceptions to the notice requirements are limited to (§230.5(a)(2))
  - a. Variable-rate changes
  - b. Check-printing fees
  - c. Short-term time accounts (one month or less)

### Pre-Maturity Notices— Renewable Accounts

- 3. For time accounts with a maturity longer than one month and that renew automatically, determine whether the proper subsequent disclosures (§230.5(b))
  - a. Are mailed or delivered at least 30 days before maturity of the existing account. Alternatively, the disclosures may be mailed or delivered at least 20 calendar days before the end of the grace period on the existing account, if a grace period of at least five days is allowed. (§230.5(b))
  - b. For accounts with maturities of more than one year, include the following information (§230.5(b)(1)):
    - i. The account disclosures required in section 230.4(b) for new accounts
    - ii. The date the existing account matures
    - iii. If the interest rate and APY are not known, include the following:
      - 1. The fact that the rates are unknown
      - 2. The date that the rates will be determined
      - 3. A telephone number to call to obtain the rates that will be paid on the new account.
  - c. For accounts with maturities of one year or less, include the following information (§230.5(b)(2)):
    - i. The account disclosures required in section 230.5(b)(1) for accounts with maturities of more than one year.  
*or*  
The date the existing account matures and the new maturity date if the account is renewed, and
    - ii. The interest and APY, if known.
    - iii. If the rates are not known, include the following:
      - 1. The fact that the rates are unknown
      - 2. The date they will be determined
      - 3. A telephone number to call to obtain

### Bonuses

- 13. Determine whether the account disclosures state the amount or type of any bonus, when the bonus will be provided, and any minimum balance and time requirements to obtain the bonus. (§230.4(b)(7))

## Subsequent Disclosures (12 CFR 230.5)

### Change in Terms Notice

- 1. Determine whether the institution sends out advance change in terms notices to consumers of any change in a term, required to be disclosed under section 230.4(b), that may reduce the annual percentage yield (APY) or that otherwise adversely affects consumers. Verify that the notice (§230.5(a)(1))
  - a. Includes the effective date of the change, and

the rates that will be paid on the new account, and

- iv. The difference in the terms of the new account, as compared to the existing account.

### Pre-Maturity Notices— Nonrenewable Accounts

- 4. For time accounts with a maturity longer than one year and that do not renew automatically, determine whether the institution (§230.5(c))
  - a. Discloses the maturity date
  - b. Discloses whether interest will be paid after maturity
  - c. Mails or delivers the disclosures at least 10 calendar days before maturity of the existing account.

### Periodic Statement Disclosures (12 CFR 230.6)

- 1. If an institution mails or delivers a periodic statement, determine whether the statements include the following (§230.6(a)):
  - a. The “annual percentage yield earned” during the statement period, using that term and calculated in accordance to Appendix A of Regulation DD; (§230.6(a)(1))
  - b. The amount of interest earned during the statement period (§230.6(a)(2)); and
  - c. Any debited fees required to be disclosed under section 230.4(b)(4) itemized by dollar amount and type. (§230.6(a)(3))
 

NOTE: Except as required in section 230.11(a)(1) for overdraft payment fees, if fees of the same type are imposed more than once in a statement period, an institution may itemize fees separately or group them together and disclose a total dollar amount for all fees of the same type. Fees for paying overdrafts and for returning items unpaid are not fees of the same type and must be separately distinguished. (Staff Commentary §230.6(a)(3)-2(iv))
  - d. The total number of days in the statement period, or the beginning and ending dates of the period. (§230.6(a)(4))
- 2. If the institution uses the average daily balance method and calculates interest for a period other than the statement period, determine whether the institution (§230.6(b))
  - a. Calculates and discloses the APY earned and the amount of interest earned based on the other period rather than the statement period, and

- b. States the information required in section 230.6(a)(4), specifying the period length for the other period as well as for the statement period.

### Payment of Interest (12 CFR 230.7)

- 1. Determine whether the institution calculates interest based on the full amount of principal in an account for each day by use of either the daily balance method or the average daily balance method. (§230.7(a)(1))
- 2. For deposit accounts that require a minimum balance to earn interest, determine whether the institution is using the same method to determine the minimum balance as it uses to determine the balance on which interest is calculated. (§230.7(a)(2))
 

NOTE: An institution may use an additional method that is unequivocally beneficial to the consumer. (§230.7(a)(2))
- 3. If an institution chooses not to pay accrued interest if the consumer closes an account prior to the date accrued interest is credited, determine whether the institution has disclosed this practice in the initial account disclosures. (Staff Commentary §230.7(b)-3)
 

NOTE: An institution is not required to compound or credit interest at any particular frequency but, if it does, it may compound or credit interest annually, semi-annually, quarterly, monthly, daily, continuously, or on any other basis. (§230.7(b) and Staff Commentary §230.7(b)-1)
- 4. Determine whether interest begins to accrue no later than the business day on which the depository institution receives provisional credit for the funds, in accordance with section 606 of the Expedited Funds Availability Act and the implementing Regulation CC, section 229.14. (§230.7(c))
- 5. Determine whether interest accrues until the day funds are withdrawn. (§230.7(c))

### Advertising (12 CFR 230.8)

#### General

- 1. Determine the types of advertising the institution uses, including visual, oral, or print, that meet the regulatory definition of an advertisement.
- 2. Determine that all types of advertisements do not contain misleading or inaccurate statements, and do not misrepresent deposit contracts. (§230.8(a)(1))
- 3. Determine that advertisements of accounts do not



- a. Refer to or describe an account as “free” or “no cost” (or contain a similar term) if any maintenance or activity fee is charged
  - b. Use the word profit to refer to interest paid on the account
  - c. Use the term “fees waived” if a maintenance or activity fee can be imposed. (§230.8(a)(2) and Staff Commentary §230.8(a)-5)
4. If an electronic advertisement displays a triggering term, determine whether the advertisement clearly refers the consumer to the location where the additional required information begins. (Staff Commentary §230.8(a)-9)
  5. For institutions that promote the payment of overdrafts in an advertisement, determine whether the advertisement includes the disclosures required by section 230.11(b). (§230.8(f))

### Permissible Advertisement Rates

6. For advertisements that state a rate of return, determine whether (§230.8(b))
  - a. The rate is stated as an “annual percentage yield” using that term and that no other rate is stated except “interest rate.”
  - b. The advertisement uses the abbreviation “APY,” the term “annual percentage yield” is stated at least once in the advertisement.
  - c. The advertisement states the interest rate, and uses the term “interest rate” in conjunction with, but not be more conspicuous than, the annual percentage yield to which it relates.
  - d. Rates are rounded to the nearest one-hundredth of one percentage point (.01 percent) and expressed to two decimal places.
7. For tiered-rate accounts, determine whether an annual percentage yield is stated for each tier, along with corresponding minimum balance requirements. (Staff Commentary §230.8(b)-1).
8. For stepped-rate accounts, determine whether all interest rates and the time period that each rate is in effect are stated. (Staff Commentary §230.8(b)-2)

### Required Additional Disclosures

9. With the exception of broadcast, electronic, or outdoor media, telephone-response machines, and indoor signs, if the annual percentage yield is stated in the advertisement, determine whether it includes the following information, as applicable, clearly and conspicuously:
  - a. For a variable rate account, that the rate may change after account opening. (§230.8(c)(1))

- b. The time period that the annual percentage yield will be offered, or a statement that it is accurate as of a specified date. (§230.8(c)(2))
- c. The minimum balance required to earn the advertised annual percentage yield. (§230.8(c)(3))
- d. For tiered accounts, the minimum balance required for each tier stated in close proximity and with equal prominence to the applicable APY, if applicable. (§230.8(c)(3))
- e. The minimum deposit to open the account, if it is greater than the minimum balance necessary to obtain the advertised annual percentage yield. (§230.8(c)(4))
- f. A statement that maintenance or activity fees could reduce the earnings on the account. (§230.8(c)(5) and Staff Commentary §230.8(c)(5)-1)
- g. For time accounts:
  - i. Term of the account. (§230.8(c)(6)(i))
  - ii. A statement that a penalty will or may be imposed for early withdrawal. (§230.8(c)(6)(ii))
  - iii. A statement that interest cannot remain on deposit and that payout of interest is mandatory for noncompounding time accounts with the following features: (§230.8(c)(6)(iii))
    1. Stated maturity greater than one year.
    2. Interest is not compounded annually or more frequently.
    3. Interest is required to be paid out at least annually.
    4. The APY is determined in accordance with section E of Appendix A of Regulation DD.

### Bonuses

10. For advertisements that state a bonus (a premium, gift, award, or other consideration worth more than \$10), determine whether they also state
  - a. The “annual percentage yield,” using that term; (§230.8(d)(1))
  - b. The time requirement to obtain the bonus; (§230.8(d)(2))
  - c. The minimum balance required to obtain the bonus; (§230.8(d)(3))
  - d. The minimum balance required to open the account, if it is greater than the minimum balance required to obtain the bonus; and (§230.8(d)(4))

- e. When the bonus will be provided. (§230.8(d)(5))

### Exemptions for Certain Advertisements

11. Advertisements made through broadcast, electronic, or outdoor media, and telephone-response machines are exempted from some of the Regulation DD advertising requirements and are only required to contain certain information. (This exemption does not apply to Internet or e-mail advertisements.) Determine whether advertisements made in these media contain the following information as applicable, clearly and conspicuously: (§230.8(e)(1) and Staff Commentary §230.8(e)(1)(i)-1)
  - a. The minimum balance required to earn the advertised annual percentage yield. For tiered accounts, the minimum balance required for each tier stated in close proximity and with equal prominence to the applicable APY, if applicable. (§230.8(c)(3))
  - b. For time accounts:
    - i. Term of the account. (§230.8(c)(6)(i))
    - ii. A statement that interest cannot remain on deposit and that payout of interest is mandatory for noncompounding time accounts with the following features: (§230.8(c)(6)(iii))
      1. Stated maturity greater than one year.
      2. Interest is not compounded annually or more frequently.
      3. Interest is required to be paid out at least annually.
      4. The APY is determined in accordance with section E of Appendix A of Regulation DD.
  - c. For advertisements that state a bonus (a premium, gift, award, or other consideration worth more than \$10):
    - i. The “annual percentage yield,” using that term. (§230.8(d)(1))
    - ii. The time requirement to obtain the bonus. (§230.8(d)(2))
    - iii. The minimum balance required to obtain the bonus. (§230.8(d)(3))
12. Indoor signs are exempted from most of the Regulation DD advertising requirements. Determine that indoor signs
  - a. Do not
    - i. Contain misleading or inaccurate statements, and do not misrepresent deposit contracts; (§230.8(a)(1))

- ii. Refer to or describe an account as “free” or “no cost” (or contain a similar term) if any maintenance or activity fee is charged; (§230.8(a))
  - iii. Use the word profit to refer to interest paid on the account; (§230.8(a)(2))
  - iv. Use the term “fees waived” if a maintenance or activity fee can be imposed. (Staff Commentary §230.8(a)-5)
- b. If a rate of return is stated, determine whether the indoor sign
    - i. States the rate as “annual percentage yield” or “APY.” No other rate may be stated except for the interest rate in conjunction with the APY to which it relates. (§230.8(b)(2)(i))
    - ii. Contains a statement advising consumers to contact an employee for further information about applicable fees and terms. (§230.8(e)(2)(ii))

### Record Retention Requirements (12 CFR 230.9)

1. Determine whether the institution has maintained evidence of compliance with Regulation DD, including rate information, advertising, and the provision of consumer disclosures at the appropriate time (including upon a consumer’s request), for a minimum of two years after disclosures are required to be made or action is required to be taken. For example, review samples of advertising and disclosures, policies and procedures, and training activities, as appropriate. (§230.9(c))

### Section 230.10—[Reserved]

### Disclosures for Institutions Advertising the Payment of Overdrafts (12 CFR 230.11)

#### Periodic Statement Disclosures

1. Determine whether the institution promotes the payment of overdrafts in an advertisement. If so, the institution is subject to Regulation DD’s disclosure and advertisement requirements for overdraft protection products. (§230.11(a)(1)(i))
2. Unless an exception under section 230.11(a)(2) applies, determine whether the institution discloses on each periodic statement (if a statement is provided) separate totals, for both the statement period and for the calendar year-to-date, for the following: (§230.11(a)(1)(ii))
  - a. The total amount for all fees or charges imposed on the account for paying checks or

other items when there are insufficient funds and the account becomes overdrawn; (§230.11(a)(1)(i)(A))

- b. The total amount for all fees imposed on the account for returning items unpaid. (§230.11(a)(1)(i)(B))
3. Determine whether the institution makes the total fee disclosures for the first statement period that begins after an institution advertises the payment of overdrafts. (§230.11(a)(3))
4. If an institution ceases advertising overdraft payments for a deposit account, determine whether the institution continues to disclose total fees for paying an overdraft or returning items unpaid until two years after the date of the last advertisement promoting the payment of overdrafts. (§230.11(a)(4))
5. If an institution acquires an account and starts advertising its overdraft payment features, determine whether it provides the required total fee disclosures for the first statement period that begins after it advertises the payment of overdrafts for the acquired account.

NOTE: If disclosures are required for the acquired account, the institution may, but is not required to, include fees imposed prior to acquisition of the account. §230.11(a)(5))

### Advertisement Requirements

6. Unless an exception under section 230.11(b)(2)-(4) applies, when an institution advertises the payment of overdrafts, determine whether the institution clearly and conspicuously discloses in advertisements
  - a. The fee(s) for the payment of each overdraft (§230.11(b)(1)(i))
  - b. The categories of transactions for which a fee may be imposed for paying an overdraft (§230.11(b)(1)(ii))
  - c. The time period by which the consumer must repay or cover any overdraft (§230.11(b)(1)(iii))
  - d. The circumstances under which the institution will not pay an overdraft (§230.11(b)(1)(iv))

# Regulation DD Examination Checklist

## Section 230.3—General Disclosure Requirements

1. Does the institution make the required disclosures clearly and conspicuously in writing and in a form the consumer may keep? (§230.3(a))	Yes	No	NA
2. If the disclosures are combined with other account disclosures, is it clear which disclosures are applicable to the consumer's account? (§230.3(a))	Yes	No	NA
3. If the institution provides in electronic form disclosures to a consumer, does the institution obtain the consumer's consent, if required, and comply with the other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 USC 7001 et seq.)? (§230.3(a))	Yes	No	NA
4. Do the disclosures reflect the terms of the legal obligation of the account agreement between the consumer and the institution? (§230.3(b))	Yes	No	NA
5. If the disclosures are provided in a language other than English, are disclosures also available in English upon request? (§230.3(b))	Yes	No	NA
6. Do the disclosures use consistent terminology when describing terms or features that are required to be disclosed? (Staff Commentary §230.3(a)-2)	Yes	No	NA
7. Does the institution substitute disclosures required by Regulation E for disclosures required by this regulation? (§230.3(c))	Yes	No	NA
8. Does the institution provide disclosures to at least one account holder if there are multiple holders? (§230.3(d))	Yes	No	NA
9. Do the institution's oral responses to a consumer's inquiry about interest rates payable on accounts state the annual percentage yield (APY)? If the institution chooses, it may state the interest rate, but no other rate. (§230.3(e))	Yes	No	NA
10. Are the APY, annual percentage yield earned (APYE), and the interest rate rounded to the nearest one-hundredth of one percentage point (.01%) and expressed to two decimal places? (§230.3(f)(1))	Yes	No	NA
a. For account disclosures, is the interest rate expressed to two or more decimal places? (§230.3(f)(1))	Yes	No	NA
11. Are the APY and APYE not more than one-twentieth of one percentage point (.05%) above or below the APY and APYE determined in accordance with Appendix A of Regulation DD? (§230.3(f)(2))	Yes	No	NA

## Section 230.4—Account Disclosures

### Delivery of Account Disclosures

#### *Account Opening*

1. Does the institution provide initial disclosures before an account is opened or a service provided, whichever is earlier? (§230.4(a)(1))	Yes	No	NA
a. If the consumer is not present when the account is open or a service is provided (and has not already received the disclosures), does the institution mail or deliver the disclosures no later than 10 business days after the account is opened or the service is provided, whichever is earlier? (§230.4(a)(1)(i))	Yes	No	NA
b. If the consumer who is not present at the institution uses electronic means to open an account or request a service, are the disclosures provided before the account is opened or the service is provided? (§230.4(a)(1)(ii))	Yes	No	NA

*Consumer Request*

2. Does the institution have full account disclosures, including complete fee schedules, available to be provided to consumers upon request? This requirement pertains to all consumer requests, whether or not the consumer is an existing customer or a prospective customer. (§230.4(a)(2)(i))	Yes	No	NA
a. If the consumer makes the request in person, does the institution have disclosures available to be provided upon request?	Yes	No	NA
b. If the consumer who is not present at the institution makes a request, does the institution mail or deliver the account disclosures within a reasonable time after it receives the request (generally no more than 10 days)? (§230.4(a)(2)(i))	Yes	No	NA
3. In providing disclosures upon request, does the institution choose one of the following options when providing rate information: (§230.4(a)(2)(ii))			
a. Specify an interest rate and APY that were offered within the most recent seven calendar days? (§230.4(a)(2)(ii)(A))	Yes	No	NA
b. State that the rate and yield are accurate as of an identified date? (§230.4(a)(2)(ii)(A)) <i>or</i>	Yes	No	NA
c. Provide a telephone number that consumers may call to obtain current rate information? (§230.4(a)(2)(ii)(A))	Yes	No	NA
4. For a time deposit account, does the institution choose to state the maturity of the time account as a term rather than a date? (§230.4(a)(2)(ii)(B))	Yes	No	NA

Content of Disclosures

*Rate Information*

5. Do account disclosures include, as applicable, (§230.4(b))			
a. The “annual percentage yield” and interest rate, using those terms? (§230.4(b)(1)(i))	Yes	No	NA
b. For fixed-rate accounts, the period of time the interest rate will be in effect? (§230.4(b)(1)(i))	Yes	No	NA
6. For variable-rate accounts, do account disclosures include the following information: (§230.4(b)(1)(ii))			
a. The fact that the interest rate and APY may change? (§230.4(b)(1)(ii)(A))	Yes	No	NA
b. How the interest rate is determined? (§230.4(b)(1)(ii)(B))	Yes	No	NA
c. The frequency with which the interest rate may change? (§230.4(b)(1)(ii)(C)) <i>and</i>	Yes	No	NA
d. Any limitation on the amount the interest rate may change? (§230.4(b)(1)(ii)(D))	Yes	No	NA

*Compounding and Crediting*

7. Do the account disclosures describe the frequency with which interest is compounded and credited? (§230.4(b)(2)(i))	Yes	No	NA
8. If consumers will forfeit interest if they close the account before accrued interest is credited, do the account disclosures include a statement that interest will not be paid in such cases? (§230.4(b)(2)(ii))	Yes	No	NA

*Balance Information*

9. As applicable, do the account disclosures (§230.4(b)(3)(i))			
a. Describe the minimum balance required to			
• Open an account? (§230.4(b)(3)(i)(A))	Yes	No	NA
• Avoid the imposition of a fee? (§230.4(b)(3)(i)(B))	Yes	No	NA
• Obtain the APY disclosed? (§230.4(b)(3)(i)(C))	Yes	No	NA
b. Describe how the minimum balance requirement is determined to avoid the imposition of a fee or to obtain the APY disclosed? (§230.4(b)(3)(i))	Yes	No	NA
c. Explain the balance computation method used to calculate interest on the account? (§230.4(b)(3)(ii))	Yes	No	NA
d. State when interest begins to accrue on noncash deposits? (§230.4(b)(3)(iii))	Yes	No	NA

*Fees*

10. Do the account disclosures state the amount of any fee that may be imposed in connection with the account (or an explanation of how the fee will be determined) and the conditions under which the fee may be imposed? (§230.4(b)(4))	Yes	No	NA
a. Regardless of whether the institution promotes overdraft payment, does it disclose specific categories of transactions that may cause an overdraft fee to be imposed on the account holder? (Staff Commentary §230.4(b)(4)-5)	Yes	No	NA

*Transaction Limitations*

11. Do the account disclosures state any limits on the number or dollar amount of withdrawals or deposits? (§230.4(b)(5))	Yes	No	NA
---	-----	----	----

*Features of Time Accounts*

12. For time accounts, do the account disclosures also include the following, as applicable: (§230.4(b)(6))			
a. The maturity date? (§230.4(b)(6)(i))	Yes	No	NA
b. A statement that a penalty will or may be imposed for early withdrawal, how it is calculated, and the conditions for its assessment? (§230.4(b)(6)(ii))	Yes	No	NA
c. If compounding occurs during the term and the interest may be withdrawn prior to maturity, a statement that the APY assumes that interest remains on deposit until maturity and that a withdrawal will reduce earnings? (§230.4(b)(6)(iii))	Yes	No	NA
d. A statement that interest cannot remain on deposit and that payout of interest is mandatory for accounts with the following features: (§230.4(b)(6)(iii))	Yes	No	NA
• With a stated maturity greater than one year	Yes	No	NA
• That do not compound interest on an annual or more frequent basis	Yes	No	NA
• That require interest payouts at least annually, and	Yes	No	NA
• That disclose an APY determined in accordance with section E of Appendix A of Regulation DD	Yes	No	NA
e. A statement of whether or not the account will renew automatically at maturity? (§230.4(b)(6)(iv))	Yes	No	NA

- |   |     |    |    |
|---|-----|----|----|
| <ul style="list-style-type: none"> <li>• If the account will renew automatically at maturity, a statement of whether or not a grace period is provided, and if so, the length of the grace period?</li> </ul> | Yes | No | NA |
| <ul style="list-style-type: none"> <li>• If the account does not renew automatically, a statement of whether interest will be paid after maturity if the consumer does not renew the account?</li> </ul>      | Yes | No | NA |

*Bonuses*

- |   |     |    |    |
|---|-----|----|----|
| 13. Do account disclosures state the amount or type of any bonus, when the bonus will be provided, and any minimum balance and time requirements to obtain the bonus? (§ 230.4(b)(7)) | Yes | No | NA |
|---|-----|----|----|

**Section 230.5—Subsequent Disclosures**

Change in Terms Notice

- |  |     |    |    |
|--|-----|----|----|
| 1. Does the institution provide advance change in terms notices to consumers of any change to a term, required to be disclosed under section 230.4(b), that may reduce the annual percentage yield or that otherwise adversely affects the consumer? (§ 230.5(a)(1)) | Yes | No | NA |
| a. Does the notice include the effective date of the change? (§ 230.5(a)(1))   | Yes | No | NA |
| b. Is the notice mailed or delivered at least 30 days before the effective date of the change? (§ 230.5(a)(1))   | Yes | No | NA |
| 2. Are exceptions to the notice requirements limited to the following: (§ 230.5(a)(2))   |     |    |    |
| a. Variable-rate changes? (§ 230.5(a)(2)(i))   | Yes | No | NA |
| b. Check-printing fees? (§ 230.5(a)(2)(ii))  | Yes | No | NA |
| c. Short-term time accounts (one month or less)? (§ 230.5(a)(2)(iii))  | Yes | No | NA |

Pre-Maturity Notices—Renewable Accounts

- |  |     |    |    |
|--|-----|----|----|
| 3. For time accounts with maturities longer than one month and that automatically renew, does the institution (§ 230.5(b)) |     |    |    |
| a. Mail or deliver subsequent disclosures at least 30 calendar days before maturity of existing account? (§ 230.5(b))      | Yes | No | NA |

(Alternatively, if grace period of at least five calendar days is allowed, disclosures may be mailed or delivered at least 20 calendar days before the end of grace period).

- |   |     |    |    |
|---|-----|----|----|
| b. For accounts with maturities longer than one year, include in the disclosures (§ 230.5(b)(1))                              |     |    |    |
| <ul style="list-style-type: none"> <li>• The account disclosures outlined in section 230.4(b) for the new account?</li> </ul> | Yes | No | NA |
| <ul style="list-style-type: none"> <li>• The date the existing account matures?</li> </ul>                                    | Yes | No | NA |
| <ul style="list-style-type: none"> <li>• If the interest rate and APY for the new account have not been determined</li> </ul> |     |    |    |
| (1) The fact that the rates have not yet been determined?   | Yes | No | NA |
| (2) The date that the rates will be determined?   | Yes | No | NA |
| (3) A telephone number to call for the interest rate and APY that will be paid on the new account?                            | Yes | No | NA |

c. For accounts with maturities of one year or less, include in the disclosures (§230.5(b)(2))			
• The account disclosures required under section 230.5(b)(1) for accounts with maturities of more than one year? (§230.5(b)(2)(i))	Yes	No	NA
<i>or</i>			
• The date the existing account matures and the new maturity date if the account is renewed? (§230.5(b)(2)(ii)(A))	Yes	No	NA
• The interest rate and APY for the new account, if known? (§230.5(b)(2)(ii)(B))	Yes	No	NA
• If the rates are not known, (§230.5(b)(2)(ii)(B))			
(1) The fact that the rates have not yet been determined?	Yes	No	NA
(2) The date they will be determined?	Yes	No	NA
(3) A telephone number to call for the interest rate and APY that will be paid on the new account?	Yes	No	NA
• Any difference in the terms of the new account, compared to the existing account? (§230.5(b)(2)(ii)(C))	Yes	No	NA

**Pre-Maturity Notices—Nonrenewable Accounts**

4. For time accounts with maturities longer than one year and that do not automatically renew, does the institution (§230.5(c))			
a. Disclose the maturity date?	Yes	No	NA
b. Disclose whether interest will be paid after maturity?	Yes	No	NA
c. Mail or deliver the disclosures at least 10 calendar days before the maturity of the existing account?	Yes	No	NA

**Section 230.6—Periodic Statement Disclosures**

1. If an institution mails or delivers a periodic statement, do the statements include the following: (§230.6(a))			
a. The “annual percentage yield earned” during the statement period, using that term and calculated in accordance to Appendix A of Regulation DD? (§230.6(a)(1))	Yes	No	NA
b. The amount of interest earned during the statement period? (§230.6(a)(2))	Yes	No	NA
c. Any debited fees required to be disclosed under section 230.4(b)(4), itemized by dollar amount and type? (§230.6(a)(3))	Yes	No	NA

NOTE: Except as required in section 230.11(a)(1) for overdraft payment fees, if fees of the same type are imposed more than once in a statement period, an institution may itemize fees separately or group them together and disclose a total dollar amount for all fees of the same type. Fees for paying overdrafts and for returning items unpaid are not fees of the same type and must be separately distinguished.

d. The total number of days in the statement period, or the beginning and ending dates of the period? (§230.6(a)(4))	Yes	No	NA
2. If the institution uses the average daily balance method and calculates interest for a period other than the statement period, does the institution (§230.6(b))			
a. Calculate and disclose the APYE and the amount of interest earned based on the other period rather than the statement period?	Yes	No	NA



- |  |     |    |    |
|--|-----|----|----|
| b. State the information required in section 230.6(a)(4), specifying the period length for the other period as well as for the statement period? | Yes | No | NA |
|--|-----|----|----|

### Section 230.7—Payment of Interest

- |  |     |    |    |
|--|-----|----|----|
| 1. Does the institution calculate interest on the full amount of principal in the account each day by use of either the daily balance method or the average daily balance method? (§230.7(a)(1))   | Yes | No | NA |
| 2. For deposit accounts that require a minimum balance to earn interest, does the institution use the same method to determine any minimum balance as it uses to determine the balance on which interest is calculated?<br><br>NOTE: An institution may use an additional method that is unequivocally beneficial to the consumer. (§230.7(a)(2))  | Yes | No | NA |
| 3. If an institution chooses not to pay accrued interest if the consumer closes an account prior to the date accrued interest is credited, does the institution disclose this practice in the initial account disclosures? (Staff Commentary §230.7(b)-3)<br><br>NOTE: An institution is not required to compound or credit interest at any particular frequency but, if it does, it may compound or credit interest annually, semi-annually, quarterly, monthly, daily, continuously, or on any other basis. (§230.7(b) and Staff Commentary §230.7(b)-1) | Yes | No | NA |
| 4. Does interest begin to accrue no later than the business day specified for interest-bearing accounts in section 606 of the Expedited Funds Availability Act and implementing Regulation CC? (§230.7(c))   | Yes | No | NA |
| 5. Does interest accrue until the day the funds are withdrawn? (§230.7(c))   | Yes | No | NA |

### Section 230.8—Advertising Requirements

#### General

- |  |     |    |    |
|--|-----|----|----|
| 1. Do the types of advertising that the institution uses, including visual, oral, or print, meet the regulatory definition of an advertisement?  | Yes | No | NA |
| 2. Do the advertisements refrain from misleading or inaccurate statements, and from misrepresenting the institution’s deposit contract? (§230.8(a)(1))   | Yes | No | NA |
| 3. Do the advertisements refrain from using (§230.8(a)(2) and Staff Commentary §230.8(a)-5)  |     |    |    |
| a. The terms “free” or “no cost” (or similar term) if any maintenance or activity fee may be imposed?  | Yes | No | NA |
| b. The word “profit” when referring to interest paid on an account?  | Yes | No | NA |
| c. The term “fees waived” if a maintenance or activity fee can be imposed?   | Yes | No | NA |
| 4. If an electronic advertisement displays a triggering term, does the advertisement clearly refer the consumer to the location where the additional required information begins? (Staff Commentary §230.8(a)-9) | Yes | No | NA |
| 5. For an institution that promotes the payment of overdrafts in an advertisement, does the advertisement include the disclosures required by section 230.11(b)? (§230.8(f))                                     | Yes | No | NA |

Permissible Advertisement Rates

6. If the institution advertises a rate of return, (§230.8(b))			
a. Is the rate stated as "annual percentage yield," using that term, and no other rate except "interest rate"?	Yes	No	NA
b. If the advertisement uses the abbreviation "APY," has the term "annual percentage yield" been stated at least once in the advertisement?	Yes	No	NA
c. If the advertisement states the interest rate, using that term, is it stated in conjunction with, but not more conspicuous than, the annual percentage yield to which it relates?	Yes	No	NA
d. Are the annual percentage yields and interest rates rounded to the nearest one-hundredth of one percentage point (.01%) and expressed to two decimal places?	Yes	No	NA
7. If the institution advertises tiered-rate accounts, does the advertisement state an annual percentage yield for each tier, along with corresponding minimum balance requirements? (Staff Commentary §230.8(b)-1)	Yes	No	NA
8. If the institution advertises stepped-rate accounts, does the advertisement state all the interest rates and the time period that each rate is in effect? (Staff Commentary §230.8(b)-2)	Yes	No	NA

Required Additional Disclosures

9. With the exception of broadcast, electronic, or outdoor media, telephone-response machines, and indoor signs, if the annual percentage yield is stated in the advertisement, is the following information, as applicable, stated clearly and conspicuously: (§230.8(c))			
a. For a variable rate account, that the rate may change after account opening? (§230.8(c)(1))	Yes	No	NA
b. The time period that the annual percentage yield will be offered, or a statement that it is accurate as of a specified date? (§230.8(c)(2))	Yes	No	NA
c. The minimum balance required to earn the advertised annual percentage yield? (§230.8(c)(3))	Yes	No	NA
d. For tiered-rate accounts, the minimum balance required for each tier stated in close proximity and with equal prominence to the applicable APY, if applicable? (§230.8(c)(3))	Yes	No	NA
e. The minimum deposit to open the account, if it is greater than the minimum balance necessary to obtain the advertised annual percentage yield? (§230.8(c)(4))	Yes	No	NA
f. A statement that maintenance or activity fees could reduce the earnings on the account? (§230.8(c)(5) and Staff Commentary §230.8(c)(5)-1)	Yes	No	NA
g. For time accounts, the following features: (§230.8(c)(6))			
• Term of the account? (§230.8(c)(6)(i))	Yes	No	NA
• A statement that a penalty will or may be imposed for early withdrawal? (§230.8(c)(6)(ii))	Yes	No	NA
• A statement that interest cannot remain on deposit and that payout of interest is mandatory for noncompounding time accounts with the following features: (§230.8(c)(6)(iii))	Yes	No	NA
(1) A stated maturity greater than one year	Yes	No	NA
(2) Interest is not compounded on an annual or more frequent basis	Yes	No	NA
(3) Interest is required to be paid out at least annually, and	Yes	No	NA

(4) The APY is determined in accordance with section E of Appendix A.

## Bonuses

10. Unless an exception applies in section 230.8(e), if a bonus is stated in an advertisement, does the advertisement state the following information, as applicable, clearly and conspicuously: (§230.8(d))
- |  |     |    |    |
|--|-----|----|----|
| a. The “annual percentage yield,” using that term? (§230.8(d)(1))  | Yes | No | NA |
| b. The time requirement to obtain the bonus? (§230.8(d)(2))  | Yes | No | NA |
| c. The minimum balance required to obtain the bonus? (§230.8(d)(3))  | Yes | No | NA |
| d. The minimum balance required to open the account, if it is greater than the minimum balance necessary to obtain the bonus? (§230.8(d)(4)) | Yes | No | NA |
| e. When the bonus will be provided? (§230.8(d)(5))   | Yes | No | NA |

## Exemptions for Certain Advertisements

11. Do advertisements made through broadcast, electronic, or outdoor media, and telephone-response machines contain the following information, as applicable, clearly and conspicuously: (§230.8(e)(1) and Staff Commentary §230.8(e)(1)(i)-1)
- |  |     |    |    |
|--|-----|----|----|
| a. The minimum balance required to earn the advertised annual percentage yield? For tiered accounts, the minimum balance required for each tier stated in close proximity and with equal prominence to the applicable APY, if applicable? (§230.8(c)(3)) | Yes | No | NA |
| b. For time accounts:  |     |    |    |
| • Term of the account? (§230.8(c)(6)(i))   | Yes | No | NA |
| • A statement that interest cannot remain on deposit and that payout of interest is mandatory for noncompounding time accounts with the following features: (§230.8(c)(6)(iii))  | Yes | No | NA |
| (1) A stated maturity greater than one year  | Yes | No | NA |
| (2) Interest is not compounded on an annual or more frequent basis   | Yes | No | NA |
| (3) Interest is required to be paid out at least annually, and   | Yes | No | NA |
| (4) The APY is determined in accordance with section E of Appendix A of Regulation DD.   | Yes | No | NA |
| c. If an advertisement states a bonus,   |     |    |    |
| • The “annual percentage yield,” using that term? (§230.8(d)(1))   | Yes | No | NA |
| • The time requirement to obtain the bonus? (§230.8(d)(2))   | Yes | No | NA |
| • The minimum balance required to obtain the bonus? (§230.8(d)(3))   | Yes | No | NA |
12. Do indoor signs
- |   |     |    |    |
|---|-----|----|----|
| a. Refrain from   |     |    |    |
| • Containing misleading or inaccurate statements, and misrepresenting deposit contracts? (§230.8(a)(1))                                   | Yes | No | NA |
| • Referring to or describing an account as “free” or “no cost” (or contain a similar term) if any maintenance or activity fee is charged? | Yes | No | NA |
| • Using the word “profit” to refer to interest paid on the account?   | Yes | No | NA |
| • Using the term “fees waived” if a maintenance or activity fee can be imposed? (§230.8(a)(2) and Staff Commentary §230.8(a)-5)           | Yes | No | NA |
| b. If a rate of return is stated,   |     |    |    |

- State the rate as “annual percentage yield” or “APY”? No other rate may be stated except for the interest rate in conjunction with the APY to which it relates. Yes    No    NA
- Contain a statement advising consumers to contact an employee for further information about applicable fees and terms? (§230.8(e)(2)) Yes    No    NA

**Section 230.9—Record Retention Requirements**

1. Has the institution retained evidence of compliance with Regulation DD, including rate information, advertising, and the provision of consumer disclosures at the appropriate time (including upon a consumer’s request), for a minimum of two years after disclosures are required to be made or action is required to be taken? For example, review samples of advertising and disclosures, policies and procedures, and training activities, as appropriate. (§230.9(c)) Yes    No    NA

**Section 230.10—RESERVED**

**Section 230.11—Overdraft Payment Disclosure and Advertising Requirements**

Periodic Statement Disclosures

1. Does the institution promote the payment of overdrafts in an advertisement? If so, it is subject to Regulation DD’s disclosure and advertisement requirements for overdraft protection products. (§230.11(a)(1)(i)) Yes    No    NA
2. Unless an exception under section 230.11(a)(2) applies, does the institution disclose on each periodic statement (if it provides a statement) separate totals, for both the statement period and the calendar year-to-date, for the following: (§230.11(a)(1)(ii))
  - a. The total amount of fees and charges imposed for paying checks or other items when there are insufficient funds and the account becomes overdrawn? (§230.11(a)(1)(i)(A) *and*) Yes    No    NA
  - b. The total amount of fees imposed on an account for returning items unpaid? (§230.11(a)(1)(i)(B)) Yes    No    NA
3. Does the institution make the total fee disclosures for the first statement period that begins after it advertises the payment of overdrafts? (§230.11(a)(3)) Yes    No    NA
4. If the institution ceases advertising overdraft payments for a deposit account, does it continue to disclose total fees for paying an overdraft or for returning items unpaid until two years after the date of the last advertisement promoting the payment of overdrafts? (§230.11(a)(4)) Yes    No    NA
5. If the institution acquired an account and starts advertising its overdraft payment features, does it provide the required total fee disclosures for the first statement period that begins after it advertises the payment of overdrafts for the acquired account? (§230.11(a)(5)) Yes    No    NA

NOTE: If disclosures are required for the acquired account, the institution may, but is not required to, include fees imposed prior to acquisition of the account. (§230.11(a)(5))

### Advertisement Requirements

6. Unless an exception under section 230.11(b)(2)-(4) applies, when an institution advertises the payment of overdrafts, are the following disclosed clearly and conspicuously in the advertisement:
- |   |     |    |    |
|---|-----|----|----|
| a. The fee(s) for the payment of each overdraft? (§230.11(b)(1)(i))   | Yes | No | NA |
| b. The categories of transactions for which a fee may be imposed for paying an overdraft? (§230.11(b)(1)(ii)) | Yes | No | NA |
| c. The time period by which the consumer must repay or cover any overdraft? (§230.11(b)(1)(iii)) and          | Yes | No | NA |
| d. The circumstances under which the institution will not pay an overdraft? (§230.11(b)(1)(iv))               | Yes | No | NA |

# Regulation C

## Home Mortgage Disclosure

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### Background

Regulation C (12 CFR 203) implements the Home Mortgage Disclosure Act (HMDA), which was enacted by Congress in 1975. The period 1988 through 1992 saw substantial changes to HMDA. Especially significant were the amendments to the act resulting from the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). The FIRREA amendments expanded coverage to many independent nondepository mortgage lenders in addition to the previously covered banks, savings associations, and credit unions. Coverage of independent mortgage bankers was further expanded in 1993 with implementation of amendments contained in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). For a detailed discussion of the history of HMDA, see the Federal Financial Institutions Examination Council's web site ([www.ffiec.gov/hmda/history2.htm](http://www.ffiec.gov/hmda/history2.htm)).

HMDA grew out of public concern about credit shortages in certain urban neighborhoods. Congress believed that some financial institutions had contributed to the decline of some geographic areas by their failure to provide adequate home financing to qualified applicants on reasonable terms and conditions. Thus, one purpose of HMDA and Regulation C is to provide the public with information that will help show whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. A second purpose is to aid public officials in distributing public-sector investments so as to attract private investment to areas where it is needed. A third purpose is to assist in identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

As the name implies, HMDA is a disclosure law. It relies on public scrutiny for its effectiveness. It does not prohibit any specific lender activity, and it does not establish a quota for mortgage lending in any metropolitan statistical area (MSA) or other geographic area defined by the Office of Management and Budget.

Lenders must report data on loan originations, applications, and purchases as well as requests under a preapproval program (as defined in section 203.2(b) of Regulation C) if the preapproval request is denied or results in the origination of a home purchase loan. They must also report the ethnicity, race, gender, and gross income of mortgage applicants and borrowers. In addition, lenders must report information on the pricing of each loan and whether the loan is subject to

the Home Ownership and Equity Protection Act (15 USC 1639). Additionally, lenders must identify the type of purchaser for each mortgage loan they sell. Some lenders have the option of indicating the reasons for their decision to deny a loan application. (Lenders regulated by the Office of the Comptroller of the Currency or the Office of Thrift Supervision *must* indicate the reasons for denial.)

Regulation C requires institutions to report lending data to their supervisory agencies on a loan-by-loan and application-by-application basis by way of a "register" reporting format. The supervisory agencies, through the Federal Financial Institutions Examination Council (FFIEC), compile this information to produce individual disclosure statements for each institution and aggregate reports for all covered institutions within each MSA. In addition, the FFIEC produces other aggregate reports that show lending patterns by median age of homes and by the central-city or non-central-city location of the property. The public can obtain the individual disclosure statements and the aggregate reports from the FFIEC or from central depositories located in each MSA. Individual disclosure statements can also be obtained from financial institutions.

### Applicability

Regulation C covers two categories of financial institutions. One is *depository institution*, which the regulation defines as a bank, savings association, or credit union that

- On the preceding December 31 had assets in excess of the annually published asset threshold,
- On the preceding December 31 had a home or branch office in an MSA,
- In the preceding calendar year originated at least one first-lien home purchase loan (or a refinancing of such a loan) on a one- to four-family dwelling, and
- Meets one of the following criteria: (1) the institution is federally insured or regulated, (2) the mortgage loan referred to is federally guaranteed, insured, or supplemented, or (3) the institution intended to sell the loan to Fannie Mae or Freddie Mac.

The other category is *for-profit, nondepository mortgage lending institution*. A for-profit, nondepository mortgage lending institution is covered by Regulation C if

- In the preceding calendar year, it originated

home purchase loans (including refinancings of home purchase loans) that either (1) totaled 10 percent or more of its loan origination volume, measured in dollars, or (2) totaled \$25 million or more,

- On the preceding December 31, it had a home or branch office in an MSA<sup>1</sup>, and
- Either (1) on the preceding December 31, it had total assets of more than \$10 million, counting the assets of any parent corporation, or (2) in the preceding calendar year, it originated at least 100 home purchase loans or refinancings of home purchase loans.

For purposes of this discussion and the examination procedures, the term “financial institution” signifies both a depository institution and a nondepository institution. The term “mortgage lending institution” applies to majority-owned mortgage lending subsidiaries of depository institutions and, since 1990, to independent mortgage companies. Mortgage lending subsidiaries of bank and savings and loan holding companies, as well as of savings and loan service corporations, have been covered by HMDA since 1988. Mortgage lending subsidiaries are treated as entities distinct from their “parent” and must file separate reports with their parent’s supervisory agency.

The Board may exempt from Regulation C a state-chartered or state-licensed financial institution that is covered by a substantially similar state law that contains adequate provision for enforcement by the state. As of January 1, 2005, no exemptions were in effect.

## Compilation of Loan Data

For each calendar year, a financial institution must report data on its applications that resulted in originations of

- Home purchase loans
- Home improvement loans
- Refinancings

Data must also be reported for loan purchases. In addition, data must be reported for applications that did not result in originations:

- Applications that were approved by the institution but were not accepted by the applicant
- Applications that were denied, withdrawn, or closed for incompleteness

Finally, data must be reported on certain denials of requests for preapproval of a home purchase

loan under a program whereby a lender issues a written commitment covering a specific period of time to lend a creditworthy borrower up to a specific amount.

Loans secured by real estate that are neither refinancings nor made for home purchase or home improvement need not be reported.

## Loan Information

For each application, financial institutions must identify the purpose of the requested or originated loan (home purchase, home improvement, or refinancing), the lien status of the property relating to the application, and whether the property will be owner-occupied as a principal dwelling. Regulation C defines terms as follows:

- *Dwelling*—A residential structure that may or may not be attached to real property located in a state, the District of Columbia, or the Commonwealth of Puerto Rico, including an individual condominium or cooperative unit, a mobile or manufactured home, and a multifamily structure such as an apartment building
- *Home purchase loan*—A loan secured by a dwelling and made for the purpose of purchasing that (or another) dwelling
- *Home improvement loan*—A loan that is to be used at least in part for the purpose of repairing, rehabilitating, remodeling, or improving a dwelling or the real property on which the dwelling is located (Home improvement loans not secured by a dwelling are to be reported only if the institution classifies the loan as a home improvement loan; dwelling-secured home improvement loans are to be reported without regard to classification.)
- *Refinancing*—A transaction in which a new obligation satisfies and replaces an existing obligation by the same borrower. To determine whether or not a loan is covered by HMDA, the existing obligation must be a home purchase loan and both the new and the existing obligations must be secured by a first lien on a dwelling. For reporting purposes, both the existing and new obligations must be secured by a lien on a dwelling.

Financial institutions are also required to identify the following general loan types: conventional, FHA-insured, VA-guaranteed, and FSA/RHS-guaranteed. In addition, they must report the property type as a one- to four-family dwelling, a multifamily dwelling, or manufactured housing. Finally, they must report the amount of the loan (or the loan applied for), the application date, the action date, and the type of action taken.

<sup>1</sup>. The institution may or may not have a physical presence in the MSA (section 203.2(c)(2)).

## Property Location

For loans on, and applications for loans on, properties located in any MSA in which the institution has a home or branch office, certain geographic location information must be reported.<sup>2</sup> For loans on properties located outside these MSAs, and outside any MSA, reporting of geographic information is optional—except in the case of large financial institutions subject to additional data reporting requirements under the Community Reinvestment Act (CRA). The geographic information consists of the MSA or MD number, codes identifying the state and county, and the census tract number of the property to which the loan or loan application relates.

Large financial institutions subject to both the CRA and HMDA must collect and report geographic information for all loans and applications (whether located in an MSA or not), not just for loans and applications relating to property in MSAs in which the institution has a home or branch office.<sup>3</sup> Under the CRA, a *large institution* is a bank or savings association that has assets of \$1 billion or more or a subsidiary of a holding company that has total banking and thrift assets of \$1 billion or more.

## Applicant Information

For applications and originated loans, financial institutions must report data on the applicant's or borrower's ethnicity, race, sex, and annual income; for purchased loans, reporting of these data is optional. The institution must request information regarding the ethnicity, race, and sex of all applicants and borrowers, including those who apply entirely by telephone, mail, or Internet. If the applicant does not provide the information and the application is submitted in person, the lender must note the information on the basis of visual observation or surname. Regulation C contains a model form that can be used to collect data on ethnicity, race, and sex. Alternatively, the form used to obtain monitoring information under section 202.13 of Regulation B (Equal Credit Opportunity) may be used.

If an institution originates or purchases a loan and then sells it in the same calendar year, it must report the type of entity that purchased the loan. Except in the case of large secondary-market purchasers such as Fannie Mae and Freddie Mac, the exact purchaser need not be identified. For example, the institution may indicate that it sold

<sup>2</sup> In the case of an MSA divided into metropolitan divisions (MDs), the relevant unit for this purpose is the MD.

<sup>3</sup> For loans and applications on properties located in a county with a population of less than 30,000, the institution may enter "NA."

a loan to a bank without identifying the particular bank.

## Pricing-Related Data

For originations of home purchase loans, dwelling-secured home improvement loans, and refinancings, financial institutions must report the spread between the annual percentage rate (APR) on a loan at consummation and the yield on comparable Treasury securities if the spread is 3 percentage points or more for first-lien loans or 5 percentage points or more for subordinate-lien loans. The following are excluded from the rate-spread reporting requirement: (1) applications that are incomplete, withdrawn, denied, or approved but not accepted, (2) purchased loans, (3) home improvement loans not secured by a dwelling, (4) assumptions, (5) home equity lines of credit, and (6) loans not subject to Regulation Z (Truth in Lending). To determine the applicable Treasury security yield, the institution must use the table "Treasury Securities of Comparable Maturity under Regulation C" on the FFIEC web site ([www.ffiec.gov/ratespread/help.aspx](http://www.ffiec.gov/ratespread/help.aspx)).

Financial institutions must report whether the loan is subject to the Home Ownership and Equity Protection Act (HOEPA) (15 USC 1639). A loan becomes subject to HOEPA when the APR or the points and fees on the loan exceed the HOEPA triggers. (Additional information on HOEPA coverage can be found in the FFIEC examination procedures for the Truth in Lending Act and HOEPA.)

Financial institutions must also report the lien status of any property related to the loan or application (first lien, subordinate lien, or not secured by a lien on a dwelling).

## Optional Data

Financial institutions supervised by the Federal Reserve (and the FDIC) may, at their option, report their reasons for denying a loan application. (Financial institutions regulated by the OCC and the OTS, including subsidiaries of national banks and savings associations, are required to provide reasons for denials, as are credit unions, which are regulated by the NCUA.) Institutions may also choose to report certain requests for preapproval that are approved by the institution but not accepted by the applicant, and home equity lines of credit made in whole or in part for the purpose of home improvement or home purchase.

## Excluded Data

Financial institutions are not required to report loan data for



- Loans originated or purchased by the institution acting as trustee or in some other fiduciary capacity
- Loans on unimproved land
- Temporary financing (such as bridge or construction loans)
- The purchase of an interest in a pool of loans (such as mortgage-participation certificates)
- The purchase of mortgage loan servicing rights
- Loans acquired as part of a merger or acquisition or the acquisition of all the assets and liabilities of a branch office

## Reporting Format

Financial institutions are required to record data on each application for, and each origination and purchase of, home purchase loans, home improvement loans, and refinancings on a form titled "Loan/Application Register," or "HMDA-LAR." They must also record data on requests under a preapproval program (as defined in section 203.2(b)), but only if the preapproval request is denied or results in the origination of a home purchase loan. Transactions are to be reported for the calendar year in which final action was taken. If a loan application is pending at the end of the calendar year, it is to be reported on the HMDA-LAR for the following year, when the final disposition is made. Loans originated or purchased during the calendar year must be reported for the calendar year of origination, even if they were subsequently sold.

The HMDA-LAR is accompanied by a list of codes to be used for each entry on the form. Detailed instructions and guidance on the requirements for the register are contained in appendix A to Regulation C. Additional information is available in the FFIEC publication "A Guide to HMDA Reporting—Getting it Right!" and on the FFIEC web site.

Financial institutions must record data on their HMDA-LAR within thirty calendar days of the end of the calendar quarter in which final action was taken. They do, however, have flexibility in determining how to maintain the register, as the entries need not be grouped in any prescribed fashion. For example, an institution could record home purchase loans on one HMDA-LAR and home improvement loans on another; alternatively, both types of loans could be reported on one register. Similarly, a separate register may be kept at each branch office, or a single register for the entire institution may be maintained at a central location. These separate registers must be combined into a single consolidated register, however, when submitted to the appropriate supervisory agency.

For each calendar year, a financial institution must submit to its supervisory agency its HMDA-LAR, accompanied by a transmittal sheet. Unless it has twenty-five or fewer reportable transactions, the institution must submit its data in automated form. For registers submitted in paper form, two copies must be mailed to the supervisory agency. For both automated and hard-copy submissions, the layout of the register must conform exactly to that of the register in appendix A to Regulation C.

The HMDA-LAR must be submitted by March 1 following the calendar year covered by the data. The FFIEC then produces a disclosure statement for each institution, cross-tabulating data on individual loans in various groupings, as well as an aggregate report for each MSA.

## Disclosure

As a result of amendments to HMDA incorporated in the Housing and Community Development Act of 1992, an institution must make its disclosure statement available to the public at its home office within three business days of its receipt from the FFIEC. The institution must also either (1) make this disclosure statement available to the public in at least one branch office in each additional MSA or MD in which it has offices within ten business days of receipt or (2) post, in each branch office in each additional MSA or MD in which it has offices, the address to which requests for copies of the statement should be sent, and then send the disclosure statement within fifteen calendar days after receiving a written request.

Also, an institution must make its loan application register available to the public, after modifying the register by deleting the following fields: application or loan number, date application was received, and date action was taken. These deletions are required so as to protect the privacy interests of applicants and borrowers. For application register requests received on or before March 1, the modified HMDA-LAR for a given year must be available by March 31; for requests received after March 1, it must be available within thirty days of receipt of the request. The modified register need contain only data relating to the metropolitan area for which the request is made.

The FFIEC also produces aggregate tables to illustrate the lending activity of all covered financial institutions in each MSA or MD. These tables and the individual disclosure statements are sent to central data depositories, such as public libraries, in each MSA or MD. A list of depositories is available from the FFIEC.

A financial institution must retain its full (unmodified) HMDA-LAR for at least three years for

examination purposes. It must also be prepared to make each modified HMDA-LAR available for three years and each FFIEC disclosure statement available for five years. When responding to specific requests for copies of the data, institutions may charge reasonable fees to cover the costs incurred in providing or producing the data for public release.

Finally, an institution must post a notice at its home office and at each branch in an MSA to advise the public of the availability of the disclosure statements.

## Enforcement

Administrative sanctions, including civil money penalties, may be imposed by the institution's supervisory agency. An error in compiling or recording loan data is not a violation of the act or the regulation if it was unintentional and occurred despite the maintenance of procedures reasonably adopted to avoid such errors.



# Regulation C

## Appendix A. HMDA Sampling Procedures

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The following sampling procedures should be applied when reviewing HMDA-LAR data for accuracy:

1. Identify and select the LAR to be reviewed. For each HMDA reporter, review both the current year's data and data submitted since the most recent consumer examination. Examinations conducted after April 30 of each year should include a review of the current year's data. Examinations conducted before April 30 should include a review of the current year's data to the extent that the institution has already entered data for the current year on the LAR. The data from a single year's LAR is the universe from which the sample is taken.
2. Determine the total number of files to be sampled, based on the size of the universe, by referring to column A of the HMDA Sampling Schedule (appendix B to this chapter). For banks at which HMDA data are not relied on in conducting fair lending or CRA examinations, the product module and examination matrix may indicate a Level II review, involving sampling as appropriate. In these instances, the examiner should choose a judgmental sample that is sufficiently large to ensure confidence in the overall accuracy of the data.
3. Select the total random sample.
  - A. From an automated download—The most important thing to remember is that the sample must be *randomly* selected from the universe. A variety of tools, including a feature in Excel, can be used to select a random sample of data electronically. The following instructions will assist you in working with Excel:
    1. Generate a random order to the universe of files from which the sample will be selected using Excel's "Random Number Generation" tool by taking the following steps:
      - a. Select the following from the Excel menu:
        - Tools
        - Add-Ins
        - Analysis Tool Pak (check the box and click "OK")
        - Tools (again)
        - Data Analysis
        - Random Number Generation (highlight and click "OK")
      - b. Respond to the items on the "Random Number Generation" screen as follows:
        - Number of Variables (leave blank)
        - Number of Random Numbers (leave blank)
        - Distribution (select "Uniform" from list)
        - Parameters (leave the default as is—it is set at 0 and 1)
        - Random Seed (leave blank)
        - Output Options (click on the "Output Range" circle, and then on the small box to the right for "Output Range")
      - c. A small screen titled "Random Number Generation" will appear. Do not enter any information directly on that screen. Rather, select the range (output location) for the random numbers by highlighting the column on the spreadsheet where you want the random numbers to go. (Use the "Shift" key and the down arrow to highlight the column.) Hint: Designating a column at the end of the spreadsheet may work best.
      - d. Click on the small box on the "Random Number Generation" screen (or press "Enter").
      - e. Click on "OK."
      - f. The random numbers are automatically assigned and placed into the designated column.
      - g. Sort the files in ascending order by random number by (1) highlighting all the data, (2) selecting "Data," (3) selecting "Sort," (4) identifying the column (containing the random numbers) by which you will sort, (5) selecting "Ascending," and (6) selecting "OK."
    2. Once the loans are placed in a random order, simply take the sample needed for HMDA verification starting at the top of the list. Be sure to save this information as a supporting workpaper.
  - B. From hard-copy LAR—As with electronic data, the sample of files selected from a hard-copy LAR must be *randomly* selected from the universe.

1. Divide the number of files in the “universe” by the desired size of the sample to determine the “interval.” If necessary, round down the interval to reach a whole number.
  2. Randomly pick a number between zero and the interval.
  3. Starting with the first file in the universe, count the items until reaching the number randomly picked. The file corresponding to the random number is the first file in the sample.
  4. Starting with the next file as number 1, count the files until reaching the number corresponding to the interval and select that file for the sample.
  5. Repeat step 4 throughout the universe until reaching the chosen sample size.
4. Review the number of files indicated for the initial file review (column B in the HMDA Sampling Schedule) according to current FRB HMDA data review procedures.
5. The examiner may stop the HMDA sampling process after reviewing the initial number of files *if* the results indicate that a very small number of files had errors in key fields.<sup>1</sup> This number is given in column D of the HMDA Sampling Schedule (“Maximum number of files with errors—Stop sampling”).
6. The examiner must complete a review of the entire random sample of files if a larger number of errors in key fields are found during the initial file review.

For example, if the HMDA universe contains 150 files, a total random sample of 56 files should be taken. The examiner may initially review 29 files. If the review of the initial 29 files identifies no more than 1 file with an error or errors in a key field, the examiner may end the review for that HMDA reporter for that universe. The examiner may then reach a statistically reliable conclusion that the findings are indicative of the universe, and resubmission is not necessary.

The need for additional file review can be determined by referring to column E of the HMDA Sampling Schedule (“Number of files with errors—Additional file review required”). If the number of files with errors in key fields identified in the initial review is shown in column E, the examiner must review the additional files in the random sample.

1. *Key fields* are defined as loan type; loan purpose; property type; owner occupancy; loan amount; action taken type; request for preapproval; application date and action date; MSA; state; county; census tract; ethnicity, race, and sex of the applicant and co-applicant; income; type of purchaser; rate spread; HOEPA status; and lien status.

For example, if the HMDA universe contains 150 files, a total random sample of 56 files should be taken. The examiner may initially review 29 files. If the review of the initial 29 files identifies 4 files with an error or errors in key fields, the examiner should then review 27 additional files, for a total sample size of 56 files. After completing review of the additional 27 files, the examiner should determine the total number of key-field errors and apply the current Board HMDA resubmission standards to the entire sample.

7. If the examiner determines that a large number of files reviewed in the initial file review have an error or errors in key fields, the examiner may stop HMDA data verification after the initial file review is completed and should apply the current Board HMDA resubmission standards.

This “large” number can be determined by referring to column F of the HMDA Sampling Schedule (“Minimum number of files with errors—Stop sampling and apply resubmission standards”). For example, if the HMDA universe contains 150 files, a total random sample of 56 files should be taken. The examiner may initially review 29 files. If the review of the initial 29 files identifies 6 (or more) files with an error or errors in key fields, the examiner should stop the review. Sufficient statistical evidence has been obtained to conclude that a larger sample would have an unacceptable number of errors, thus requiring resubmission. At this point, the examiner should apply the current Board HMDA resubmission standards to the entire sample.

## Provisional HMDA Data Sampling Procedures

In 2004, the Board temporarily revised the HMDA sampling procedures in light of errors in 2004 data in some of the new key data fields.<sup>2</sup> Specifically, the Board increased the required sample sizes, to help ensure the integrity of the HMDA data reported by banks and used by examiners in fair lending and CRA analyses. The provisional sampling procedures, which are described below, are to be in effect until further notice.

Using the sampling procedures described earlier in this appendix and the sample sizes given in appendix B as a starting point, review the sampled loans and possibly increase the number of loans in the sample to ensure that loans *originated by the bank* (HMDA action code 1) make up at least

2. These new fields include race, ethnicity, sex, lien status, Home Ownership and Equity Protection Act status, and loan pricing data.

50 percent of the items in the sample.<sup>3</sup> If in the original randomly selected sample fewer than 50 percent of applications were originated by the bank, continue to randomly select applications with action code 1 until the number of originations reaches at least 50 percent of the number of items required to be sampled. For example,

HMDA universe	100
Sample size according to CA 04-04 guidelines	39
Random sample selected	
Action code 1 (Originations) (28%)	11
Action code 2 (Approved not accepted)	4
Action code 3 (Denied)	7
Action code 4 (Withdrawn)	4
Action code 5 (Incomplete)	2
Action code 6 (Purchased)	5
Action code 7 (Preapproval denied)	4
Action code 8 (Preapproval not accepted)	2
Additional originations required for the sample	9
Revised sample size	48

### Special Sampling Method for HOEPA Loan Originations

This sampling method is designed to determine if the bank's procedures for calculating APR spreads and identifying HOEPA loans are accurate and to ensure that those loans that were reported as HOEPA loans, as well as those that were not, were identified correctly. If the random sample selected for HMDA data verification, as outlined earlier in this appendix, does not include enough loans to fulfill the sampling requirements described below, a targeted sample of loans should be selected to meet the minimum requirements. *The targeted loans should be reviewed only to determine if the*

<sup>3</sup> The sampling guidance in this chapter is based on CA Letter 04-4.

*rate spread was accurately computed and the HOEPA status correctly reported.*

- *Banks at which fewer than 10 percent of originated loans have APRs above HOEPA thresholds*—Review 6 first-lien loans and 6 subordinate-lien loans, for a total of 12 loans (see section 226.32 of Regulation Z for a discussion of thresholds). If possible, in each set of 6 loans include 3 high-cost non-HOEPA loans having an APR of 1 point or less below the HOEPA trigger and 3 HOEPA loans having an APR of 1 point or less above the trigger. If the bank does not have that many loans with an APR within 1 point above or below the trigger, select loans with an APR beyond the 1 point margin to bring the total sampled to 12.

This methodology has been selected because looking at close cases is most likely to reveal whether the creditor is correctly designating HOEPA loans. For both first and subordinate liens, if the bank originated fewer than 3 high-cost non-HOEPA loans with APRs below the HOEPA thresholds or fewer than 3 loans with APRs above the thresholds, review all the loans in that category.

- *Banks at which more than 10 percent of originated loans have APRs above the HOEPA thresholds*—Review a minimum of 10 first-lien and 10 subordinate-lien loans, for a total of 20 loans. If possible, in each set of 10 loans include 5 high-cost non-HOEPA loans having an APR of 1 point or less below the HOEPA trigger and 5 HOEPA loans having an APR of 1 point or less above the trigger. If the bank does not have that many loans with an APR within 1 point above or below the trigger, select loans with an APR beyond the 1 point margin.

For both first and subordinate liens, if the bank originated fewer than 5 high-cost non-HOEPA loans having APRs below the HOEPA thresholds or fewer than 5 loans with APRs above the thresholds (but nonetheless meets the 10 percent criterion), review all the loans in that category.



# Regulation C

## Appendix B. HMDA Sampling Schedule

HMDA universe	Initial file review					Additional file review	Additional number of loans originated by bank	Total random sample <sup>2</sup>
	Initial file review	Minimum number of loans originated by bank	Maximum number of files with errors <sup>1</sup> — Stop sampling	Number of files with errors <sup>1</sup> — Additional file review required (go to column G)	Minimum number of files with errors <sup>1</sup> — Stop sampling and apply resubmission standards			
(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)
1–11	Review all	6						
12–20	12	6	0	1	2	Review all	Review all	All
21–30	13	7	0	1	2	Review all	Review all	All
31–50	15	8	0	1–2	3	13	7	28
51–70	17	9	0	1–2	3	12	6	29
71–90	18	9	0	1–3	4	20	10	38
91–110	28	14	1	2–3	4	11	6	39
111–130	29	15	1	2–4	5	18	9	47
131–140	29	15	1	2–4	5	20	10	49
141–170	29	15	1	2–5	6	27	14	56
171–190	30	15	1	2–5	6	27	14	57
191–270	30	15	1	2–5	6	29	15	59
271–380	30	15	1	2–6	7	38	19	68
381–750	31	16	1	2–6	7	38	19	69
751–1,100	31	16	1	2–7	8	48	24	79
1,101 or more	32	16	1	2–7	8	47	24	79

1. Files with one or more errors in key fields. Key fields are defined as loan type; loan purpose; property type; owner occupancy; loan amount; action taken type; request for preapproval; application date and action date; MSA; state; county; census tract; ethnicity, race, and sex of the applicant and co-applicant; income; type of purchaser; rate spread; HOEPA status; and lien status.

2. The total random sample could be larger if the minimum number of loans originated by the bank is not found in the original sample.





# Regulation C

## Appendix C. HMDA Resubmission Standards

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To ensure the integrity of the HMDA data used for analysis, the following guidelines should be followed when considering whether to have an institution resubmit HMDA data. The guidelines cover two general categories of assessments: assessments of the accuracy of the data in individual data fields, and assessments of overall accuracy.

### Individual Data Fields

Institutions should be required to correct and resubmit data in certain “key” fields on the HMDA-LAR when at least 5.0 percent of the files sampled contain inaccurate data within a key field. These fields are

- Loan type
- Loan purpose
- Property type
- Owner occupancy
- Loan amount
- Action taken type
- Request for preapproval
- Application date
- Action date
- MSA
- State
- County

- Census tract
- Ethnicity of the applicant and co-applicant
- Race of the applicant and co-applicant
- Sex of the applicant and co-applicant
- Income
- Type of purchaser
- Rate spread
- HOEPA status
- Lien status

Errors in rounding amounts in the “loan amount” and “income” fields should not be counted toward the 5 percent resubmission standard, although the violations should be cited and the bank should report the data correctly in the future. When the regression program is used during an examination, each of the key fields except “state,” “county,” “census tract,” “applicant sex,” and “co-applicant sex” must have an error rate of less than 5.0 percent before the step 1 regression program is run.

### Overall Accuracy

If at least 10.0 percent of the sampled files contain an error in at least one key field, the entire HMDA-LAR must be resubmitted. The institution must verify the data in each of the fields, not just in those with an error rate greater than 5.0 percent.



# Regulation C

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

1. To appraise the quality of the financial institution's compliance risk management system to ensure compliance with the Home Mortgage Disclosure Act and Regulation C
2. To determine how much reliance can be placed on the financial institution's compliance risk management system for ensuring its compliance with the Home Mortgage Disclosure Act and Regulation C, including such elements as internal controls, policies, procedures, and compliance review and audit functions
3. To determine the accuracy and timeliness of the financial institution's submitted HMDA-LAR
4. To initiate corrective action when policies or internal controls are deficient or when violations of law or regulation are identified

Note: If HMDA and Regulation C are applicable, the following examination procedures should be completed separately for the depository institution and any of its majority-owned mortgage subsidiaries, and a separate checklist should be completed for each institution subject to HMDA and Regulation C. Also, when determining whether a financial institution is subject to HMDA, the examiner should remain cognizant of any newly created MSAs and changes in MSA boundaries, including the addition or deletion of counties to or from an MSA, thus causing a financial institution either to become a new HMDA reporter or to no longer be a HMDA reporter. For a list of counties in an MSA, by state, see the FFIEC web site and the publication "A Guide to HMDA Reporting—Getting It Right!"

### EXAMINATION PROCEDURES

#### A. Initial Procedures

##### Depository Institutions

1. Determine whether the depository institution is subject to the requirements of HMDA and Regulation C by determining if the regulatory criteria addressed in sections 203.2(e)(1)(i)–203.2(e)(1)(iv) are met.

##### Mortgage Subsidiaries

1. Determine whether the depository institution has a majority ownership in a mortgage subsidiary that meets relevant criteria in sections 203.2(e)(2)(i)–203.2(e)(2)(iii). If all relevant criteria are met, the subsidiary is subject to the requirements of HMDA and Regulation C.
2. Determine whether the depository institution has been involved in any mergers or acquisitions since January 1 of the preceding calendar year.
  - a. If it has been, determine whether the required HMDA data for the acquired financial institution(s) were reported separately or in consolidation. The examination procedures in the following sections that concern accuracy and disclosure also apply to an acquired financial institution's data, even if those data are reported separately.

#### B. Evaluation of Compliance Management

The examiner should obtain the information necessary to make a reasonable assessment of the financial institution's ability to collect data on applications for, and originations and purchases of, home purchase loans, home improvement loans, and refinancings for each calendar year, in accordance with the requirements of HMDA and Regulation C.

The examiner should determine, through a review of written policies, internal controls, and the HMDA Loan/Application Register(s) (HMDA-LAR) and discussions with management, whether the financial institution has adopted and implemented comprehensive procedures to ensure adequate compilation of home mortgage disclosure information in accordance with sections 203.4(a)–203.4(e).

During the review of the financial institution's system for maintaining compliance with HMDA and Regulation C, the examiner should obtain and review policies and procedures, along with any applicable audit and compliance program materials, to determine whether

1. Policies, procedures, and training are adequate, on an ongoing basis, to ensure compliance with Regulation C
2. Internal review procedures and audit schedules comprehensively cover all the pertinent regulatory requirements associated with Regulation C

3. The audits or internal analysis performed include a reasonable amount of transactional analysis and a reasonable number of written reports that detail findings and recommendations for corrective action
4. Internal reviews include any regulatory changes that may have occurred since the prior examination
5. The financial institution has assigned one or more individuals responsibility for oversight, data update, and data entry, as well as for timeliness of the institution's data submission. The examiner should also determine whether the institution's board of directors is informed of the results of all analyses.
6. The individuals who have been assigned responsibility for data entry receive appropriate training for completion of the HMDA-LAR and also receive copies of instructions—appendix A to Regulation C (Forms and Instructions for Completion of the HMDA-LAR); the staff commentary to Regulation C; and the FFIEC publication “Guide to HMDA Reporting—Getting it Right!”—in a timely manner
7. The financial institution has ensured effective corrective action in response to previously identified deficiencies
8. The financial institution performs HMDA-LAR volume analysis from year to year to detect increases or decreases in activity that might indicate omissions of data
9. The financial institution maintains documentation for those loans it packages and sells to other institutions

### C. Evaluation of Policies and Procedures

Evaluate whether the financial institution's informal procedures and internal controls are adequate to ensure compliance with Regulation C. Consider the following:

1. Whether the individuals assigned responsibility for the financial institution's compliance with Regulation C have an adequate level of knowledge and have established a method for staying abreast of changes to laws and regulations
2. If the financial institution ensures that individuals assigned compliance responsibility receive adequate training to ensure compliance with the requirements of the regulation
3. Whether the individuals assigned compliance responsibility know whom to contact, at the financial institution or their supervisory agency, if they have questions not answered by the written materials
4. If the financial institution has established and implemented adequate controls to ensure the separation of duties (for example, data entry, review, oversight, and approval)
5. Any internal reports or records documenting revisions to policies and procedures, as well as any informal self-assessments of the financial institution's compliance with the regulation
6. If the financial institution offers preapprovals, whether the institution's preapproval program meets the specifications detailed in the HMDA regulation; and, if so, whether the institution's policies and procedures provide adequate guidance for the reporting of preapproval requests that are approved or denied, in accordance with the regulation
7. Whether the financial institution's policies and procedures address the reporting of (1) non-dwelling-secured loans that are originated in whole or in part for home improvement and are classified as such by the institution and (2) dwelling-secured loans that are originated in whole or in part for home improvement, whether or not classified as such
8. Whether the financial institution has established a method for determining and reporting the lien status of property associated with all originated loans and applications
9. Whether the financial institution's policies and procedures contain guidance for collecting ethnicity, race, and sex data for all loan applications, including applications made by telephone, mail, and Internet
10. Whether the financial institution's policies and procedures address the collection of data on the rate spread (the difference between the APR on the loan and the comparable Treasury yield), and whether the institution has established a system for tracking rate “lock dates” and calculating the rate spread
11. Whether the financial institution's policies and procedures address how to determine if a loan is subject to the Home Ownership and Equity Protection Act and the reporting of applications involving loans for manufactured homes
12. Whether the HMDA-LAR is updated within thirty days after the end of each calendar quarter
13. Whether data are collected at all branches and, if so, whether the appropriate personnel are sufficiently trained to ensure that all branches are reporting data under the same guidelines

14. Whether the financial institution's loan officers, including loan officers in the commercial loan department who may handle loan applications reportable under HMDA (including loans and applications for multifamily and mixed-use properties and small business refinances secured by residential real estate), are informed of the reporting requirements necessary to assemble the information
15. Whether the financial institution's board of directors has established an independent review of the policies, procedures, and HMDA data to ensure compliance and accuracy and is advised each year of the accuracy and timeliness of the institution's data submissions
16. What procedures the financial institution has put in place to comply with the requirement to submit data in machine-readable form, and whether the institution has some mechanism in place to ensure the accuracy of the data that are submitted in machine-readable form
17. Whether the financial institution's loan officers are familiar with the disclosure, reporting, and retention requirements associated with loan/application registers and FFIEC public disclosure statements
18. Whether the financial institution's loan officers are familiar with the disclosure statements that will be produced from the data
19. Whether the financial institution's loan officers are aware that civil money penalties may be imposed if an institution has submitted erroneous data and has not established adequate procedures to ensure the accuracy of the data
20. Whether the financial institution's loan officers are aware that correction and resubmission of erroneous data may be required when data for at least 5 percent of loan/application records are incorrectly reported

## D. Transaction Testing

Verify that the financial institution accurately compiled home mortgage disclosure information on a register in the format prescribed in appendix A to Regulation C, by reviewing a sample of applications. For submitted data, the review should include a sample of the applications represented on the HMDA-LAR. A sample of the current year's data should also be reviewed. In both cases, the sample should include

1. Approved and denied transactions subject to HMDA
2. Housing-related purchased loans
3. Withdrawn housing-related loan applications

## E. Disclosure and Reporting

1. Determine whether the financial institution
  - a. Submits its HMDA-LAR to the appropriate supervisory agency no later than March 1 following the calendar year for which the data are compiled and maintains its HMDA-LAR for at least three years thereafter
 

Note: Financial institutions that report twenty-five or fewer entries on their HMDA-LAR may collect and report HMDA data in paper form. Financial institutions opting to submit their data in such a manner must send two typed or computer-printed copies. They must use the format of the HMDA-LAR but need not use the form itself.
  - b. Makes its FFIEC disclosure statement available to the public at its home office no later than three business days after receiving its statement from the FFIEC
  - c. Either (1) makes its FFIEC disclosure statement available to the public in at least one branch office in each additional MSA or MD in which it has offices within ten business days after receiving the disclosure statement from the FFIEC or (2) posts, in the lobby of each branch office in additional MSAs or MDs in which it has offices, the address to which written requests for the disclosure statement should be sent, and then mails or delivers a copy of the disclosure statement within fifteen calendar days of receiving a written request
  - d. Makes its modified HMDA-LAR (modified by removal of loan application numbers, dates applications were received, and dates action was taken) available to the public by March 31 for requests received on or before March 1 and within thirty days for requests received after March 1
  - e. Has retained its modified HMDA-LARs for three years and its disclosure statements for five years, and has policies and procedures to ensure that its modified HMDA-LARs and disclosure statements are available to the public during those terms
  - f. Makes its modified HMDA-LARs and disclosure statements available for inspection and copying during the hours the office is normally open to the public for business. If it imposes a fee for costs incurred in providing or reproducing the data, the fee should be reasonable.
  - g. Posts a general notice about the availability of its HMDA data in the lobby of its home office and of each branch office located in an MSA

- h. Provides promptly, upon request, the location of the financial institution's offices where the statement is available for inspection and copying, or includes the location in the lobby notice
  2. If the financial institution has a subsidiary covered by HMDA, determine that the subsidiary completed a separate HMDA-LAR and submitted it either directly or through its parent to the parent's supervisory agency.
  3. Determine that the HMDA-LAR transmittal sheet was completed accurately and that an officer of the financial institution signed and certified to the accuracy of the data contained in the register. (Refer to appendix A of Regulation C.) Note: If the HMDA-LAR was submitted via the Internet, the signature should be retained on file at the institution.
  4. Review the financial institution's most recent disclosure statement, HMDA-LAR, modified HMDA-LAR, and any applicable correspondence, such as notices of noncompliance. Determine whether errors occurred during the previous reporting period and, if errors did occur, what steps the institution took to correct and prevent such errors in the future.
  5. Determine whether the financial institution has the necessary tools to compile the geographic information.
    - a. Determine whether the financial institution uses the FFIEC geocoding web site ([www.ffiec.gov/geocode/default.htm](http://www.ffiec.gov/geocode/default.htm)); the U.S. Census Bureau's Census Tract Street Address Lookup Resources for 2000; the Census Bureau's 2000 Census Tract Outline Maps; LandView 5-equivalent materials available from the Census Bureau or from a private publisher; or an automated geocoding system to obtain census tract numbers.
    - b. If the financial institution relies on outside assistance to obtain census tract numbers (for example, private "geocoding" services or real estate appraisals), verify that adequate procedures are in place to ensure that the census tract numbers are obtained when they are not provided by the outside source. For example, if the institution usually uses property appraisals to obtain census tract numbers, it must have procedures to obtain this information when an appraisal is not received, such as when a loan application is denied before an appraisal is made.
- c. Verify that the financial institution has taken steps to ensure that the provider of outside services is using the appropriate 2000 Census Bureau data.
    - d. Verify that the financial institution uses current MSA and MD definitions to determine MSA and MD numbers and boundaries. MSA definitions and numbers (and state and county codes) are available from the supervisory agency and from the FFIEC publication "A Guide to HMDA Reporting—Getting it Right!"
  6. For financial institutions required under the CRA to report data on small business, small farm, and community development lending, verify that they also collect accurate data on property located outside MSAs or MDs in which they have a home or branch office, or outside any MSA or MD.

## F. Examination Conclusions

1. Summarize the findings, supervisory concerns, and regulatory violations.
2. For the violations noted, determine the root cause by identifying weaknesses in internal controls, audit and compliance reviews, training, management oversight, or other factors; also, determine if the violations are repetitive, isolated, or systemic.
3. Identify action needed to correct violations and weaknesses in the financial institution's compliance system.
4. Discuss findings with the financial institution's management, and obtain a commitment to take corrective action.

# Regulation C Examination Checklist

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## Applicability

### Depository Institutions

- |   |     |    |
|---|-----|----|
| 1. Is the depository institution a bank, savings association, or credit union that in the preceding calendar year originated at least one home purchase loan (or refinancing of a home purchase loan) secured by a first lien on a one- to four-family dwelling? (§ 203.2(e)(1)(iii)) | Yes | No |
| 2. Does the depository institution meet at least one of the following criteria?   |     |    |
| a. The depository institution is a federally insured or regulated institution (§ 203.2(e)(1)(iv)(A))  | Yes | No |
| b. The depository institution originated a mortgage loan (see question 1) that was insured, guaranteed, or supplemented by a federal agency (§ 203.2(e)(1)(iv)(B))  | Yes | No |
| c. The depository institution originated a mortgage loan (see question 1) intending to sell it to Fannie Mae or Freddie Mac (§ 203.2(e)(1)(iv)(C))  | Yes | No |
| 3. Did the depository institution have either a home or a branch office in an MSA on December 31 of the preceding calendar year? (§ 203.2(e)(1)(ii))  | Yes | No |
| 4. On the preceding December 31 did the depository institution have assets in excess of the asset threshold that is adjusted annually and published annually by the Federal Reserve Board? (§ 203.2(e)(1)(i))   | Yes | No |

If the answers to questions 1–4 are “yes,” the depository institution is subject to the requirements of HMDA and Regulation C, and the examiner should complete the remainder of the checklist

### Mortgage Subsidiaries

- |  |     |    |
|--|-----|----|
| 5. Is the depository institution a majority owner of a for-profit mortgage subsidiary? | Yes | No |
|--|-----|----|

If the answer to question 5 is “yes,” complete questions 6–8; otherwise, proceed to question 9.

- |   |     |    |
|---|-----|----|
| 6. In the preceding calendar year, did the mortgage subsidiary either   |     |    |
| a. Originate home purchase loans or refinancings of home purchase loans that together equaled at least 10 percent of its total loan-origination volume, measured in dollars, or (§ 203.2(e)(2)(i)(A)) | Yes | No |
| b. Originate home purchase loans or refinancings of home purchase loans that together equaled at least \$25 million (§ 203.2(e)(2)(i)(B))   | Yes | No |
| 7. Did the mortgage subsidiary have a home or branch office in an MSA as of December 31 of the previous year? <sup>1</sup> (§ 203.2(e)(2)(ii))  | Yes | No |
| 8. Does the mortgage subsidiary meet at least one of the following criteria? (§ 203.2(e)(2)(iii))   |     |    |
| a. The mortgage subsidiary had total assets (when combined with the assets of the parent corporation) exceeding \$10 million on the previous December 31  | Yes | No |

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<sup>1</sup> A nondepository institution is deemed to have a branch office in an MSA or MD if, in the preceding calendar year, it received applications for, originated, or purchased five or more home purchase loans, home improvement loans, or refinancings in that MSA or MD.



- |   |     |    |
|---|-----|----|
| b. The mortgage subsidiary originated at least 100 home purchase loans (including refinancings of home purchase loans) in the preceding calendar year | Yes | No |
|---|-----|----|

If the answers to questions 6–8 are “yes,” the mortgage subsidiary is subject to the requirements of HMDA and Regulation C. If the depository institution that has a majority interest in the mortgage subsidiary is also subject to HMDA and Regulation C, the examiner should complete a separate checklist for each entity, beginning with question 9 for the mortgage subsidiary. If the depository institution that has a majority interest in the mortgage subsidiary is not subject to Regulation C and HMDA, the examiner should use the remaining portion of this checklist for the mortgage subsidiary. The examiner should note the financial institution to which the remaining checklist questions apply.

## Compilation of Loan Data

- |   |     |    |
|---|-----|----|
| 9. Does the financial institution collect the following data in accordance with section 203.4(a) and appendix A of the regulation?  |     |    |
| a. An identifying number (that does not include the applicant’s name or Social Security number) for the loan or loan application, and the date the application was received (§ 203.4(a)(1)) | Yes | No |
| b. The type of the loan or application (§ 203.4(a)(2))  | Yes | No |
| c. The purpose of the loan or application (§ 203.4(a)(3))   | Yes | No |
| d. Whether the application was for a preapproval, and whether it resulted in a denial or an origination (§ 203.4(a)(4))   | Yes | No |
| e. The property type to which the loan or application relates (§ 203.4(a)(5))   | Yes | No |
| f. The owner-occupancy status of the property to which the loan or application relates (§ 203.4(a)(6))  | Yes | No |
| g. The loan amount or the amount requested on the application (§ 203.4(a)(7))   | Yes | No |
| h. The type of action taken (§ 203.4(a)(8))   | Yes | No |
| i. The date such action was taken (§ 203.4(a)(8))   | Yes | No |
| j. The location of the property to which the loan or application relates, by (§ 203.4(a)(9))  |     |    |
| i. MSA or MD number (5 digits)  | Yes | No |
| ii. State (2 digits)  | Yes | No |
| iii. County (3 digits)  | Yes | No |
| iv. Census tract number (6 digits)  | Yes | No |
| k. The ethnicity and race of the applicant or borrower (§ 203.4(a)(10))   | Yes | No |
| l. The ethnicity and race of the co-applicant or co-borrower (§ 203.4(a)(10))   | Yes | No |
| m. The sex of the applicant or borrower (§ 203.4(a)(10))  | Yes | No |
| n. The sex of the co-applicant or co-borrower (§ 203.4(a)(10))  | Yes | No |

Note: Collection of data on ethnicity, race, and sex is mandatory for all transactions unless the financial institution purchased the loans or the borrower is not a natural person (that is, is a corporation or partnership).

o. The gross annual income relied on in processing the applicant's request (§ 203.4(a)(10))	Yes	No
Note: Collection of data on annual income is mandatory for all transactions unless the financial institution purchased the loan, the borrower is not a natural person, the loan is for a multifamily dwelling, income was not relied on in the credit decision, or the loan was made to an employee.		
p. The type of entity purchasing a loan that the financial institution originates or purchases and then sells within the same calendar year (§ 203.4(a)(11))	Yes	No
q. For originated loans subject to Regulation Z, the difference between the loan's APR and the yield on Treasury securities having a comparable maturity period, if the APR equals the yield on the Treasury security with a comparable maturity period or exceeds it by 3 percentage points for first-lien loans and 5 percentage points for subordinate-lien loans (§ 203.4(a)(12))	Yes	No
r. Whether the loan is subject to HOEPA (§ 203.4(a)(13))	Yes	No
s. The lien status of the property relating to the loan or application (§ 203.4(a)(14))	Yes	No
t. Does the institution provide the reasons for denial of an application? (§ 203.4(c)(1))	Yes	No
If it does, are the reasons accurate?	Yes	No
u. Is the HMDA-LAR updated within thirty calendar days after the end of the quarter in which final action is taken? (§ 203.4(a))	Yes	No
10. Does the institution request ethnicity, race, and sex data for all telephone, mail, and Internet applications in accordance with appendix B to Regulation C? (§ 203.4(b)(1))	Yes	No
11. For applications taken face to face, does the institution note data concerning ethnicity, race, and sex on the basis of visual observation or surname if the applicant chooses not to provide this information? (§ 203.4(b)(1))	Yes	No
Note: If the applicant fails to provide this information in mail, telephone, or Internet applications, ethnicity, race, and sex are not recorded; instead, an applicable code number is provided—ethnicity, 3; race, 6; and sex, 3 ("NA" should not be used for these three situations).		

## Disclosure and Reporting

12. Is the loan or applicant data presented in the format prescribed in appendix A to Regulation C? (§ 203.4(a))	Yes	No
13. Has the institution reported all applications for, originations of, and purchases of home purchase loans, home improvement loans, and refinancings? (§ 203.4(a))	Yes	No
14. Has the financial institution refrained from reporting the following? (§ 203.4(d))		
a. Loans originated or purchased by the financial institution acting in a fiduciary capacity (such as trustee)	Yes	No
b. Loans on unimproved land	Yes	No
c. Temporary financing (such as a bridge or construction loan)	Yes	No
d. Purchase of an interest in a pool of loans (such as mortgage-participation certificates, mortgage-backed securities, or real estate mortgage investment conduits)	Yes	No
e. Purchase solely of the right to service loans	Yes	No

<p>f. Loans acquired as part of a merger or acquisition or as part of the acquisition of all assets and liabilities of a branch office</p>	<p>Yes</p>	<p>No</p>
<p>g. A refinancing if, under the loan agreement, the financial institution is unconditionally obligated to refinance the obligation, or is obligated to refinance the obligation subject to conditions under the borrower's control (Regulation C, appendix A, I(A)(5a))</p>	<p>Yes</p>	<p>No</p>
<p>15. Did the financial institution submit its completed HMDA-LAR to the appropriate supervisory agency in automated machine-readable format by March 1 following the calendar year during which the data were compiled? (§ 203.5(a))</p> <p>Note: Financial institutions that report twenty-five or fewer entries on their HMDA-LAR may collect and report their HMDA data in paper form. Financial institutions opting to submit their data in such a manner must send two typed or computer-printed copies. The institution must use the format of the HMDA-LAR but need not use the form itself.</p>	<p>Yes</p>	<p>No</p>
<p>16. Has an officer of the financial institution signed the HMDA-LAR transmittal sheet certifying the accuracy of the data contained in the register?</p>	<p>Yes</p>	<p>No</p>
<p>17. Is the transmittal sheet accurately completed?</p>	<p>Yes</p>	<p>No</p>
<p>18. Has the financial institution maintained its HMDA-LAR in its records for at least three years? (§ 203.5(a))</p>	<p>Yes</p>	<p>No</p>
<p>19. Has the financial institution made its FFIEC-prepared disclosure statement</p>		
<p>a. Available to the public at its home office no later than three business days after receiving it from the FFIEC and</p>	<p>Yes</p>	<p>No</p>
<p>b. Available within ten business days in at least one branch office in each additional MSA or MD in which it has offices; or posted, in the lobby of each branch office in other MSAs or MDs in which it has offices, the address to which written requests should be sent, and delivered a copy of the disclosure statement within fifteen calendar days of receiving a written request (§ 203.5(b))</p>	<p>Yes</p>	<p>No</p>
<p>20. Has the financial institution made its modified HMDA-LAR (modified by removal of loan application numbers, dates applications were received, and dates of action taken) for the preceding calendar year available to the public by March 31 for requests received on or before March 1 and within thirty days for requests received after March 1? (§ 203.5(c))</p>	<p>Yes</p>	<p>No</p>
<p>21. Has the financial institution retained its modified HMDA-LARs for three years?</p> <p>Does the institution have policies and procedures to ensure that its modified HMDA-LARs are available to the public during that term? (§ 203.5(d))</p>	<p>Yes</p>	<p>No</p>
<p>22. Has the financial institution retained its disclosure statements for five years? (§ 203.5(d))</p>	<p>Yes</p>	<p>No</p>
<p>23. Does the financial institution have policies and procedures to ensure that its disclosure statements are available to the public during that term? (§ 203.5(d))</p>	<p>Yes</p>	<p>No</p>
<p>24. Does the financial institution make its modified HMDA-LARs and disclosure statements available for inspection and copying during the hours the office is normally open to the public for business?</p> <p>If it imposes a fee for costs incurred in providing or reproducing the data, is the fee reasonable? (§ 203.5(d))</p>	<p>Yes</p>	<p>No</p>
<p>25. Has the financial institution posted a general notice about the availability of its disclosure statement in the lobby of its home office and in each branch office located in an MSA? (§ 203.5(e))</p>	<p>Yes</p>	<p>No</p>

- |   |     |    |
|---|-----|----|
| 26. Does the institution provide promptly, upon request, the location of the institution's offices where the statement is available for inspection and copying, or include the location in the lobby notice? (§ 203.5(e))   | Yes | No |
| 27. Did errors occur in the previous reporting period? (Review the financial institution's most recent disclosure statement, HMDA-LAR, modified HMDA-LAR, and any applicable correspondence from the regulatory agency, such as notices of noncompliance.)                              | Yes | No |
| 28. If errors did occur, has the financial institution taken appropriate steps to correct and prevent such errors in the future?  |     |    |
| a. Do individuals who are responsible for all data entry  |     |    |
| i. Receive appropriate training in the completion of the HMDA-LAR   | Yes | No |
| ii. Receive copies of Regulation C, including instructions for completion of the HMDA-LAR and the FFIEC publication "A Guide to HMDA Reporting—Getting it Right!"   | Yes | No |
| iii. Know whom to contact, at the financial institution or the institution's supervisory agency, if they have questions not answered by the written materials   | Yes | No |
| b. Are the financial institution's loan officers, including loan officers in the commercial loan department who may handle loan applications for HMDA reportable loans (such as multifamily and mixed-use properties and small business refinances secured by residential real estate), |     |    |
| i. Informed of the reporting requirements so they can assemble the necessary information, and do they understand the importance of accuracy   | Yes | No |
| ii. Familiar with the disclosure statements that are produced from the data and cognizant of the ramifications for the financial institution if the data are wrong  | Yes | No |
| iii. Do they maintain appropriate documentation of the information entered on the HMDA-LAR?   | Yes | No |
| c. If data are collected at more than one branch, are the appropriate personnel sufficiently trained to ensure that all branches are reporting data using the same guidelines?  | Yes | No |
| d. Does the financial institution have internal control processes to ensure that the individuals who capture and code the data are doing so accurately and consistently?  | Yes | No |
| e. Does the financial institution have established controls to ensure the separation of duties (for example, data entry, review, oversight, and approval)?  | Yes | No |



# Regulation H

## Flood Insurance

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### Background

The Board's Regulation H (Membership of State Banking Institutions in the Federal Reserve System) implements the flood insurance provisions of the National Flood Insurance Act of 1968 for state member banks. This legislation made federally subsidized flood insurance available to owners of improved real estate or mobile homes located in a special flood hazard area if their community participates in the National Flood Insurance Program. The Flood Disaster Protection Act of 1973 directed the Board and other federal financial regulatory agencies to adopt rules requiring regulated lenders to require flood insurance on improved real estate or mobile homes serving as collateral for a loan if the property was located in, or was to be located in, a special flood hazard area in a participating community.<sup>1</sup>

The National Flood Insurance Reform Act of 1994 (Reform Act; Title V of the Riegle Community Development and Regulatory Improvement Act of 1994) comprehensively revised the federal flood insurance statutes.<sup>2</sup> The reforms were aimed at increasing compliance with flood insurance requirements, increasing participation in the National Flood Insurance Program (and thereby providing additional income to the National Flood Insurance Fund), and decreasing the financial burden of flooding on the federal government, taxpayers, and flood victims.<sup>3</sup>

The Reform Act required the federal financial regulatory agencies to revise their existing flood insurance regulations and brought the Farm Credit Administration under the act. Because none of the flood-related laws provide rule-writing authority solely to one financial regulator, in August 1996 the agencies jointly issued a final rule (61 FR 45684) that incorporated the changes to the agencies' flood regulations.

The Reform Act also applied flood insurance requirements directly to the loans purchased by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) and to agencies that provide government insurance or guarantees, such as the Small Business Administration, the Federal

Housing Administration, and the Department of Veterans Affairs.

The objectives of the Flood Disaster Protection Act (FDPA) include

- Providing flood insurance to owners of improved real estate located in special flood hazard areas (SFHAs) of communities participating in the National Flood Insurance Program (NFIP)
- Requiring communities to enact measures designed to reduce or avoid future flood losses as a condition for making federally subsidized flood insurance available
- Requiring federal financial regulatory agencies to adopt regulations prohibiting their regulated lending institutions from making, increasing, extending, or renewing a loan secured by improved real estate or a mobile home located, or to be located, in an SFHA of a community participating in the NFIP unless the property securing the loan is covered by flood insurance
- Prohibiting federal agencies, such as the Federal Housing Administration, the Small Business Administration, and the Department of Veterans Affairs, from subsidizing, insuring, or guaranteeing any loan if the property securing the loan is in an SFHA of a community not participating in the NFIP

The National Flood Insurance Program is administered by the Federal Emergency Management Agency (FEMA).<sup>4</sup> Its responsibilities include

- Identifying communities with SFHAs
- Issuing flood-boundary and flood-rate maps for flood-prone areas
- Making flood insurance available through the NFIP "Write Your Own" program, which enables the public to purchase NFIP coverage from private companies that have entered into agreements with the Federal Insurance Administration
- Assisting communities in adopting floodplain-management requirements
- Administering the insurance program (Licensed property and casualty insurance agents and brokers provide the primary connection between the NFIP and the insured party. Licensed agents sell flood insurance, complete the insured party's application form, report claims, and follow up with the insured for renewals of the policies.)

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1. The two acts are codified at 42 USC 4001–4129. The regulatory agencies are the OCC, FDIC, OTS, NCUA, and the Federal Reserve.

2. Pub. L. 103-325, tit. V, 108 Stat. 2160, 2255–87 (September 23, 1994).

3. H.R. Conf. Rep. No. 652, 103d Cong., 2d Sess. 195 (1994) (Conference Report).

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4. FEMA regulations implementing the NFIP appear at 44 CFR 59–77.

## Requirements for Lending Institutions

### Basic Requirements

A lending institution must require flood insurance for the term of a loan when all three of the following factors are present:

- The institution makes, increases, extends, or renews a loan (commercial or consumer) secured by improved real estate or a mobile home that is affixed to a permanent foundation,
- The loan is secured by property located in a special flood hazard area as identified by FEMA, and
- The community participates in the NFIP. (Information on whether a community participates in the NFIP can be obtained from FEMA's web site, [www.fema.gov](http://www.fema.gov).)

In the case of mobile homes, the criteria for coverage relate to whether the mobile home is affixed to a permanent foundation. An institution does not have to obtain a security interest in the underlying real estate in order for the loan to be covered.

Institutions are not prohibited from making, increasing, extending, or renewing a conventional loan in an SFHA if the community in which the security property is located has been mapped by FEMA but does not participate in the NFIP. However, federal flood insurance is not available in these communities. Moreover, institutions may not make government-guaranteed or government-insured loans if the community has been mapped by FEMA and does not participate in the NFIP.

Flood insurance requirements also apply to loans where a security interest in improved real property is taken only "out of an abundance of caution." Section 102(b)(1) of the FDPA, as amended by the Reform Act, provides that a regulated lending institution may not make, increase, extend, or renew any loan secured by improved real property that is located in a special flood hazard area unless the improved real property is covered by the minimum amount of flood insurance required by statute.<sup>5</sup>

### Special Situation—Table-Funded Loans

In the typical table-funding situation, the party providing the funding reviews and approves the credit standing of the borrower and issues a commitment to the broker or dealer to purchase the loan at the time the loan is originated. Frequently, all loan documentation and other statutorily mandated notices are supplied by the party providing the funding, rather than the broker or dealer. The

funding party provides the original funding "at the table" when the broker or dealer and the borrower close the loan. Concurrent with the loan closing, the funding party acquires the loan from the broker or dealer. While the transaction is, in substance, a loan made by the funding party, it is structured as a loan purchase.

A typical table-funded transaction should be considered a loan that is made, rather than purchased, by the entity that actually supplies the funds. Regulated institutions that provide table funding to close loans originated by a mortgage broker or mobile home dealer are considered to be "making" a loan for purposes of the flood insurance requirements.

Treating table-funded loans as loans made by the funding entity need not result in duplication of flood-hazard determinations and borrower notices. The funding entity may delegate to the broker or dealer originating the transaction the responsibility for fulfilling the flood insurance requirements or may otherwise divide the responsibilities with the broker or dealer, as is currently done with respect to the requirements under the Real Estate Settlement Procedures Act.

### Exemptions from the Purchase Requirement

The flood insurance purchase requirement does not apply to the following two loan situations:

- Loans on state-owned property covered under an adequate policy of self-insurance satisfactory to the director of FEMA (The director will periodically publish a list of state property falling within this exemption.)
- Loans having (1) an original principal balance of \$5,000 or less and (2) an original repayment term of one year or less

A lending institution may not exempt a loan from flood coverage on the basis of its own interpretation of the elevations at which floods may occur. Only FEMA has the authority to revise or amend flood maps and to make flood-level determinations that exempt a loan from the required purchase of flood insurance. As part of its duties, FEMA provides official elevation determinations, makes map revisions or amendments, and issues formal Letters of Map Amendments (LOMAs) and Letters of Map Revisions (LOMRs).

### Amount of Flood Insurance Required

The amount of flood insurance required must be at least equal to the lesser of (1) the outstanding principal balance of the loan, (2) the maximum amount available under the NFIP, or (3) the total

5. See 42 USC 4012a(b)(1).

value of the secured property (land and improvements) minus the total value of the land.

Flood insurance is not available, and thus is not required, for the value of any land that serves as security for a loan. As a result, when determining the amount of flood insurance required, an institution should deduct the value of the land from the total value of the secured property (land plus improved real property or mobile home) to estimate an amount for flood coverage. Unless a structure (improved real property or mobile home) located on the land is specifically excluded from serving as security for the loan, flood insurance should be required on all insurable structures located on the secured property, including cases in which the value of the land alone would more than adequately cover the loan amount. In such cases, the lender does not have the option of exempting the borrower from the flood insurance purchase requirements for insurable structures located on the secured property.

Since March 1995, the maximum amounts of coverage for flood policies have been

- \$250,000 for residential property structures and \$100,000 for contents
- \$500,000 for nonresidential structures and \$500,000 for contents

## Waiting Period

Flood insurance policies that are not issued in conjunction with a loan origination, refinance, modification, or forced placement have a thirty-day waiting period. The congressional intent behind this waiting period was to prevent the purchase of flood insurance (and any direct loss to the U.S. government, which backs the insurance) in times of imminent loss.

There is no waiting period for policies issued in conjunction with a loan to purchase, refinance, or modify an existing mortgage. Nor is there a waiting period for second mortgages, home equity loans, “forced placements” (see later section), or recommendations by the insurer to increase insurance amounts at renewal.<sup>6</sup>

Initial purchases of flood insurance made in connection with a map revision or an update to floodplain areas of flood zones are also exempted from a waiting period. In these cases, however, the flood insurance purchase must occur within one year of FEMA’s publication of the notice of map revision or updating.

6. FEMA Policy Issuance 5-98, effective October 1, 1998.

## Special Situations—Second Mortgages and Home Equity Loans

Both second mortgages and home equity loans come within the purchase provisions of the FDPA. As only one NFIP policy may be issued for a building, an institution should not request a new flood insurance policy if one already exists. Instead, the institution should have the borrower contact the insurance agent

- To inform the agent of the intention to obtain a loan involving a subordinate lien
- To obtain verification of the existence of a flood insurance policy
- To check whether the amount of insurance covers all loan amounts

After obtaining this information, the insurance agent should increase the amount of coverage, if necessary, and issue an endorsement that identifies the institution as a lien holder.

For loans with approved lines of credit to be used in the future, calculating the amount of insurance for the loan may be difficult, as the borrower will be drawing down differing amounts on the credit line at different times. In those instances in which there is no policy on the collateral, the borrower must, at a minimum, obtain a policy as a requirement for drawing on the line. As a matter of administrative convenience to ensure compliance with the requirements, an institution may take the following approaches:

- Review its records periodically so that as draws are made against the line or repayments are made to the account, the appropriate amount of insurance coverage is maintained
- Upon origination, require the purchase of flood insurance for the total amount of the loan, the maximum amount of flood insurance coverage available, or the value of the secured property minus the land, whichever is less

## Special Situation—Condominium Policies

Condominium associations are able to manage their flood insurance needs and meet their by-law requirements without relying on the actions of the unit owners under a special type of flood insurance policy issued by FEMA—a Residential Condominium Building Association Policy (RCBAP).

A unit owner’s mortgage lender has no direct interest in an RCBAP and should not be named on the policy. However, a unit owner should provide its mortgage lender evidence of the RCBAP by supplying a copy of the declarations page documenting the specific dollar amount of coverage. If



the unit owner's mortgage lender determines that the coverage purchased under the RCBAP is insufficient to meet the mandatory purchase requirements, it should request that the borrower ask the association to carry adequate limits or should require the borrower to purchase a separate policy.

The maximum amount of building coverage that may be purchased on a high-rise or low-rise condominium under the RCBAP is the replacement cost value of the building or the total number of units in the condominium building multiplied by \$250,000, whichever is less. The maximum allowable contents coverage is the actual cash value of the commonly owned contents up to a maximum of \$100,000 per building.

## Escrow Requirements

An institution must require the escrow of flood insurance premiums for loans secured by "residential improved real estate" if it requires the escrow of other funds to cover other charges associated with the loan, such as taxes, premiums for hazard or fire insurance, or other fees. Depending on the type of loan, the escrow account for flood insurance premiums may be subject to section 10 of the Real Estate Settlement Procedures Act (RESPA), (12 USC 2609). This section generally limits the amount that may be maintained in escrow accounts for consumer mortgage loans and requires notices containing escrow account statements for those accounts. RESPA escrow requirements apply to "federally related mortgage loans," a category of loans that is narrower in scope than the Reform Act's "residential improved real estate." An escrow account for "residential improved real estate" that is not also a "federally related mortgage loan" must comply with the escrow requirements of the Reform Act but does not need to comply with section 10 of RESPA.

The escrow provisions are designed to improve compliance with flood insurance requirements by ensuring that homeowners located in special flood hazard areas obtain and maintain flood insurance for the life of the loan. However, the Reform Act itself does not restrict the flood insurance escrow requirement to consumer mortgage loans. The determinative factor in the coverage of the escrow requirement is not the purpose of the loan, but the purpose of the building—whether it is used primarily for residential purposes or for other purposes. Because the Reform Act defines "residential improved real estate" as "improved real estate for which the improvement is a residential building," the escrow provisions cover, for example, multi-family properties containing five or more residential units.

## Types of Escrow Accounts Covered

The escrow requirement does not apply if the institution does not require the maintenance of other escrows or the establishment of an escrow account in connection with the particular type of loan, even if permitted by the loan documents. In determining whether an escrow account arrangement is voluntary, it is appropriate to look to the loan policies and practices of the institution and the contractual agreement underlying the loan. If the loan documentation permits the institution to require an escrow account and its loan policies normally would require an escrow account for a loan with particular characteristics, an escrow account in connection with such a loan generally would not be considered to be voluntary.

Voluntary payments for credit life insurance do not constitute escrows for purposes of RESPA.<sup>7</sup> As a result, payments for credit life insurance and similar types of contracts should not trigger the escrow of flood insurance premiums.

## Standard Flood Hazard Determination Form

Whenever an institution makes, increases, extends, or renews any loan secured by improved real property or a mobile home, it must use the Standard Flood Hazard Determination Form (SFHDF) developed by FEMA. This form, which may be used in printed or electronic format, helps lenders determine whether the improved real property or mobile home securing the loan is located in a special flood hazard area.

The institution must retain a copy of the completed form, in either hard copy or electronic format, for the period of time it owns the loan. If it uses an electronic format, the institution may alter the format and need not follow the layout of the SFHDF exactly. However, the institution must use the fields and elements listed on the form. A copy of the form is available on FEMA's web site ([www.fema.gov](http://www.fema.gov)).

## Reliance on Prior Determination

When determining whether flood insurance is required, an institution may consider the conclusions from a previous flood hazard area determination if both of the following conditions are met:

- The previous determination is not more than seven years old.
- The basis for that determination was recorded on the SFHDF mandated by the Reform Act.

7. See 60 FR 24733 (May 9, 1995) (revising 24 CFR 3500.17).

An institution may not rely on a previous determination in two situations:

- If FEMA’s map revisions or updates show that the security property is now located in an SFHA
- If the lender contacts FEMA and learns that map revisions or updates affecting the security property have been made since the date of the previous determination

An institution may not rely on a previous determination set forth on an SFHDF when it makes a loan—only when it increases, extends, renews, or purchases a loan. Subsequent transactions by the same institution with respect to the same property, such as assumptions, refinancings, and second-lien loans, are to be treated as loan renewals. In those limited circumstances, a new determination is not required, assuming that the other requirements are met.

## Forced-Placement Requirements

Although an institution is not required to monitor for map changes, if at any time during the life of the loan the institution or its servicer determines that flood insurance is required or is deficient, the institution must take steps to “force place” the required insurance.

Under the Reform Act, an institution, or a servicer acting on its behalf, must purchase, or force-place, flood insurance for the borrower if the institution or the servicer determines that the security property is not covered by any insurance or by an adequate amount of flood insurance. Before purchasing flood insurance in the appropriate amount on the borrower’s behalf, however, the institution must first provide the borrower with a notice of the deficiency and the opportunity to obtain the correct amount of insurance. If the borrower fails to obtain the insurance within forty-five days of the date of the notice, the institution may force-place the insurance.

As long as an institution owns a loan subject to flood insurance requirements, the institution or its servicer continues to be responsible for ensuring that flood insurance is maintained as required. If a borrower allows a required policy to lapse, the institution or its servicer is required to commence forced-placement procedures.<sup>8</sup>

Forced placement is not a consideration at the time an institution makes, increases, extends, or renews a loan, as a lender is obligated to require that flood insurance be in place prior to closing. Forced-placement authority is designed to be used

when an institution or its servicer, during the course of the loan, determines that flood insurance coverage on the security property is required and is either deficient or missing. There is no required specific form of notice to borrowers for use in connection with the forced-placement procedures. An institution or its servicer may choose to send the notice directly or may use the insurance company that issues the forced-placement policy to send the notice.

An optional program—the Mortgage Portfolio Protection Program—has been developed by FEMA to assist lenders with the placement of insurance when only limited underwriting information is available. The rates that may be charged for force-placed policies are considerably higher than the rates available for voluntary policies because of the absence of underwriting data.

## Determination Fees

An institution or its servicer may charge a reasonable fee to the borrower for the costs of making a flood-hazard determination under the following circumstances:

- The determination is triggered by a borrower-initiated transaction (that is, the lender is making, increasing, extending, or renewing a loan at the borrower’s request).
- The determination reflects FEMA’s revision of maps.
- The determination results in the purchase of flood insurance by the lender under the forced-placement provision.

The authority to charge a borrower a reasonable fee for a flood-hazard determination extends to a fee for life-of-loan monitoring by either the institution, its servicer, or a third party, such as a flood-hazard-determination company.

## Truth in Lending Act Issues

The official staff commentary to Regulation Z states that fees associated with real estate mortgage transactions are excluded from the finance charge if they are imposed solely in connection with the initial decision to grant credit.<sup>9</sup> Thus, the fee for conducting an initial flood-hazard determination is excluded from the finance charge. However, the exclusion does not apply to fees for services to be performed periodically during the term of the loan, regardless of when the fee is collected. Thus, a fee for one or more determinations of the current flood insurance requirements during the loan term is a

8. The insurance carrier should notify the institution or its servicer, along with the borrower, when the insurance contract is due for renewal. The insurance carrier also notifies these parties if it has not received the policy renewal.

9. See 12 CFR 226.4(c)(7)-3 of the official staff commentary.

finance charge, regardless of whether the fee is imposed at closing or when the service is performed. If a creditor is uncertain about what portion of a fee to be paid at consummation or loan closing is related to the initial decision to grant credit, the entire fee may be treated as a finance charge.

## Notice Requirements

When the security property is or will be located in a SFHA, the institution must provide a written notice to the borrower and the servicer. The notice must be provided whether the security property is located in a participating or a nonparticipating community. The notice must also be provided even if the lender is relying on a prior determination.

The written notice must contain the following information:

- A warning that the building or mobile home is or will be located in a SFHA
- A description of the flood insurance purchase requirements contained in section 102(b) of the FDPA, as amended
- A statement as to whether flood insurance coverage is available under the NFIP and may also be available from private insurers
- A statement as to whether federal disaster relief assistance may be available in the event of damage to the building or mobile home caused by flooding in a federally declared disaster

An institution may use the sample form contained in appendix A to section 208.25 of Regulation H to comply with the notice requirements. Lenders are free to add information to the form, personalize the form, or change its format if they wish. However, to ensure compliance with the notice requirements, a lender-revised notice must provide the borrower, at a minimum, with the information required by the regulation.

## Reliance on Assurances by the Seller or Lessor

An institution may rely on assurances from a seller or lessor that the seller or lessor has provided the requisite notice to the purchaser or lessee. This alternate form of notice might be used in a situation in which the lender is providing financing through a developer for the purchase of condominium units by multiple borrowers. Because the lender may not deal directly with individual condominium unit purchasers, the lender need not provide notice to each purchaser but may instead rely on the developer or seller's assurances that the developer or seller has given the required notice. The same may be true for a cooperative conversion, in which the sponsor of the conversion may be providing

the required notice to the purchasers of the cooperative shares. A purchaser of shares in a cooperative may be considered a "lessee" rather than a purchaser with respect to the underlying real property.

## Timing of Notice

Delivery of notice must take place within a "reasonable time" before completion of the transaction. What constitutes "reasonable" notice will necessarily vary according to the circumstances of particular transactions. In any case, a borrower should receive notice in time to ensure that he or she has the opportunity to

- Become aware of the borrower's responsibilities under the NFIP and
- Purchase flood insurance before completion of the loan transaction, if applicable.

The Board (and the other agencies) generally continues to regard ten days as a "reasonable" time interval.

## Notice to the Servicer

Loan servicers must also be notified of loans secured by properties located in special flood hazard areas. In many cases, however, the servicer's identity is not known until well after the closing; consequently, notification to the servicer in advance of the closing would not be possible or would serve no purpose. As a result, notice to the servicer should be given as promptly as practicable after the institution provides notice to the borrower, and no later than at the time the lender transmits to the servicer other loan data concerning hazard insurance and taxes. The delivery of a copy of the borrower's notice to the servicer will suffice as notice to the servicer.

## Notice to the Director of FEMA

An institution must notify the director of FEMA, or the director's designee, of the identity of the loan servicer and of any change in the servicer. FEMA has designated the insurance carrier as its designee to receive notice of the servicer's identity and of any change therein. Notice of the identity of the servicer enables FEMA's designee to provide notice to the servicer forty-five days before expiration of a flood insurance contract.

An institution must also notify the director of FEMA (or its designee) within sixty days of the effective date of the transfer of servicing. The notice may be given electronically or by other means acceptable to FEMA's designee. Although no standard form of notice is required, the informa-

tion should be sufficient to enable the director, or the director's designee, to identify the security property and the loan as well as the new servicer and its address.

## Recordkeeping Requirements

An institution must retain

- Copies of completed SFHD forms, in either hard copy or electronic format, for as long as the institution owns the loan
- Records of the receipt of the notice to the borrower and the servicer for as long as the institution owns the loan

No particular form is required for the record of receipt; however, the record should contain a statement from the borrower indicating that the borrower has received the notification. Examples of records of receipt include

- A borrower's signed acknowledgment on a copy of the notice
- A borrower-initialed list of documents and disclosures that the lender provided the borrower
- A scanned electronic image of a receipt or other document signed by the borrower

An institution may keep the record of receipt provided by the borrower and the servicer in the

form that best suits the institution's business. Institutions that retain these records electronically must be able to retrieve them within a reasonable time.

## Penalties and Liabilities

Civil money penalties may be imposed for violations of the following:

- Flood insurance purchase requirements
- Escrow requirements
- Notice requirements
- Forced-placement requirements

If an institution is found to have a pattern or practice of committing violations, the agencies must assess civil penalties in an amount not to exceed \$385 per violation, with a total amount against any one regulated institution not to exceed \$125,000 in any calendar year. (These amounts are periodically adjusted for inflation. The most recent adjustments occurred in 2004.) Penalties are paid into the National Flood Mitigation Fund. Liability for violations may not be transferred to a subsequent purchaser of a loan. Liability for penalties expires four years from the time of the occurrence of the violation.



# Regulation H—Flood Insurance Examination Objectives and Procedures

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## EXAMINATION OBJECTIVES

1. To determine whether an institution performs required flood determinations for loans secured by improved real estate or a mobile home affixed to a permanent foundation in accordance with the regulation
  2. To determine if the institution requires flood insurance in the correct amount when it makes, increases, extends, or renews a loan secured by improved real estate or a mobile home located or to be located in a standard flood hazard area (SFHA)
  3. To determine if the institution provides the required notices to the borrower, the servicer, and the director of the Federal Emergency Management Agency (FEMA) whenever flood insurance is required as a condition of the loan
  4. To determine if the institution requires flood insurance premiums to be escrowed when flood insurance is required on a residential building and other items are required to be escrowed
  5. To determine whether the institution complies with the forced-placement provisions if at any time during the term of a loan it determines that flood insurance on the loan is not sufficient to meet the requirements of Regulation H
  6. To initiate corrective action when policies or internal controls are deficient, or when violations of law or regulation are identified
2. Verify that the process used accurately identifies SFHAs.
  3. For those SFHAs identified, determine if the communities in which they are located participate in the National Flood Insurance Program (NFIP).
  4. If the institution provides “table funding” to close loans originated by mortgage brokers or dealers, verify that it complies with regulatory requirements.
  5. If the institution purchases servicing rights, review the contractual obligations placed on the institution, as servicer, by the owner of the loans to ascertain if flood insurance requirements are identified and compliance responsibilities are adequately addressed.
  6. If the institution uses a third party to service loans, review the contractual obligations between the parties to ascertain that flood insurance requirements are identified and compliance responsibilities are adequately addressed.

## EXAMINATION PROCEDURES

The examination procedures should be followed, as appropriate, by

- Reviewing previous examinations and supervisory correspondence
- Obtaining copies of and reviewing the institution’s policies, procedures, and other pertinent information
- Reviewing the institution’s system of internal controls
- Discussing issues with management
- Reviewing a sample of loan files

### Coverage and Internal Control

1. Determine the method(s) used by the institution to ascertain whether improved real estate or mobile homes are or will be located in an SFHA.

### Property Determination Requirements

1. Verify that flood-zone determinations are accurately prepared on the Standard Flood Hazard Determination Form (SFHDF).
2. Verify that the institution relies on a previous determination only if the determination is no more than seven years old and is recorded on the SFHDF and that the property is not in a community that has been remapped.
3. If the institution uses a third party to prepare flood-zone determinations, review the contractual obligations between the parties to ascertain that flood insurance requirements are identified and compliance responsibilities are adequately covered, including provisions concerning the extent of the third party’s guarantee of work and the procedures in place to resolve disputes relating to determinations.
4. Verify that the institution retains a copy of the completed SFHDF, in either hard copy or electronic format, for as long as it owns the loan.

### Purchase Requirements

1. For loans that require flood insurance, determine that sufficient insurance was obtained prior to loan closing and is maintained for the life of the loan.

2. If the institution makes loans insured or guaranteed by a government agency (Small Business Administration, Department of Veterans Affairs, or Federal Housing Administration), determine how it complies with the requirement not to make these loans if the security property is in a SFHA within a nonparticipating community.

### Determination-Fee Requirements

1. Determine that any fees the institution charges to the borrower for flood-zone determinations are (absent some other authority, such as contract language) charged only when a loan
  - Is made, increased, renewed, or extended
  - Is made in response to a remapping by FEMA
  - Results in the purchase of flood insurance under the forced-placement provisions
2. If other authority permits the institution to charge fees for determinations in situations other than the ones listed in item 1, determine if the institution is consistent in this practice.
3. Determine the reasonableness of any fees charged to a borrower for flood determinations by evaluating the method used by the institution to determine the amount of the charge. Consider, for example, the relationship of the fees charged to the cost of the services provided.

### Notice Requirements

1. Ascertain that written notice is mailed or delivered to the borrower within a reasonable time prior to loan closing.
2. Verify that the notice contains
  - A warning that the property securing the loan is or will be located in a SFHA
  - A description of the flood insurance purchase requirements
  - A statement, if applicable, that flood insurance coverage is available under the NFIP and may also be available from private insurers
  - A statement as to whether federal disaster relief assistance may be available in the event of damage to the property caused by flooding in a federally declared disaster
3. If the seller or lessor provided the notice to the purchaser or lessee, verify that the institution obtained satisfactory written assurance that the

notice was provided within a reasonable time before completion of the sale or lease transaction.

4. Verify that the institution retains a record of receipt of the notice provided to the borrower for as long as it owns the loan.
5. If applicable, verify that the institution has provided written notice to the servicer of the loan within the prescribed time frames and that the institution retains a record of receipt of the notice for as long as it owns the loan.
6. If the institution transfers the servicing of loans to another servicer, ascertain whether it provides notice of the new servicer's identity to the flood insurance carrier (the director of FEMA's designee) within sixty days of the effective date of the transfer of the servicing.

### Escrow Requirements

1. If the institution's policies or loan documents require the escrow of funds to cover such charges as taxes, premiums for hazard insurance, or other fees, verify that the institution requires the escrow of funds for loans secured by residential improved real estate to cover premiums and other charges associated with flood insurance.
2. For loans closed after October 1, 1996, if flood insurance is required and the loan is subject to the Real Estate Settlement Procedures Act (RESPA), verify that the institution's escrow procedures comply with section 10 of RESPA (section 3500.17 of HUD Regulation X).

### Forced-Placement Requirements

1. If the institution determines that flood insurance coverage is less than the amount required by the Flood Disaster Protection Act of 1973, ascertain that it has appropriate policies and procedures in place to exercise its forced-placement authority.
2. If the institution is required to force-place insurance, verify that
  - The institution provides written notice to the borrower that flood insurance is required
  - If the borrower does not purchase the required insurance within forty-five days from the time the institution provides the written notice, that the institution purchases the required insurance on the borrower's behalf

# Regulation H—Flood Insurance Examination Checklist

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## Coverage

- |  |     |    |
|--|-----|----|
| 1. Does the institution offer or extend credit (consumer or commercial) that is secured by improved real estate or mobile homes as defined in Regulation H?  | Yes | No |
| • If it does, complete the remainder of this checklist.  |     |    |
| 2. If the institution provides “table funding” to close loans originated by mortgage brokers or dealers, does it have procedures to ensure that the requirements of the regulation are followed?                             | Yes | No |
| 3. If the institution purchases servicing rights to loans covered by the regulation, do the documents between the parties specify the contractual obligations on the institution with respect to flood insurance compliance? | Yes | No |
| 4. If the institution uses third parties to service loans covered by the regulation, do the contractual documents between the parties meet the requirements of the regulation?   | Yes | No |

## Property Determination

- |   |     |    |
|---|-----|----|
| 1. If the institution uses a third party to prepare flood-zone determinations, do the contractual documents between the parties   |     |    |
| • Provide for the third party’s guarantee of work   | Yes | No |
| • Contain provisions to resolve disputes relating to determinations, to allocate responsibility for compliance, and to address which party will be responsible for penalties incurred for noncompliance | Yes | No |
| 2. Are the determinations prepared on the Standard Flood Hazard Determination Form (SFHDF) developed and authorized by the Federal Emergency Management Agency (FEMA)?                                  | Yes | No |
| • If the form is maintained in electronic format, does it contain the elements required by FEMA?  | Yes | No |
| 3. Does the institution maintain a record of the SFHDF in either hard copy or electronic format for as long as it owns the loan?  | Yes | No |
| 4. Does the institution rely on a prior determination only if it was made on the SFHDF and is no more than seven years old and the community has not been remapped?                                     | Yes | No |

## Determination Fees

- |   |     |    |
|---|-----|----|
| 1. Absent some other authority (such as contract language), does the institution charge a fee to the borrower for a flood determination only when the determination is made or results from |     |    |
| • A loan origination, increase, renewal, or extension   | Yes | No |
| • A response to a remapping by FEMA   | Yes | No |
| • The purchase of flood insurance under the forced-placement provisions   | Yes | No |
| 2. If the institution has other authority to charge fees for determinations in situations other than those noted in item 1, is the practice followed consistently?                          | Yes | No |



- |  |     |    |
|--|-----|----|
| 3. If the institution requires the borrower to obtain life-of-loan monitoring and passes that charge along to the borrower   |     |    |
| • Does it either break out the original determination charge from the charge for life-of-loan monitoring or include the full amount of the charge as a finance charge for those loans subject to the Truth in Lending Act? | Yes | No |
| 4. Are the fees charged by the institution for making a flood determination reasonable?  | Yes | No |

### Notice Requirements

- |   |     |    |
|---|-----|----|
| 1. Are borrowers whose security property is located in a special flood hazard area (SFHA) provided written notice within a reasonable time prior to loan closing?                                   | Yes | No |
| 2. Does the notice contain the following required information?  |     |    |
| • A warning that the building or mobile home is located in a SFHA   | Yes | No |
| • A description of the flood insurance requirements   | Yes | No |
| • A statement that flood insurance is available under the National Flood Insurance Program and may also be available from private insurers  | Yes | No |
| • A statement as to whether federal disaster relief assistance may be available in the event of damage to a building or mobile home caused by flooding in a federally declared disaster             | Yes | No |
| 3. If the institution uses the alternate notice procedures in certain instances as permitted by Regulation H, does it obtain the required satisfactory written assurance from the seller or lessor? | Yes | No |
| 4. Does the institution provide a copy of the borrower notification to the servicer of the loan within the required time frames?  | Yes | No |
| 5. Does the institution retain a record of receipt of the notifications provided to the borrower and the servicer for as long as it owns the loan?  | Yes | No |

### Insurance Requirements

- |   |     |    |
|---|-----|----|
| 1. If an improved property or mobile home is located in a SFHA and flood insurance is required, does the institution have the borrower obtain a policy, with the institution as loss payee, in the correct amount prior to closing?                                   | Yes | No |
| 2. When multiple properties securing the loan are located in SFHAs, does the institution have sufficient insurance, through either a single policy with a scheduled list of several buildings or multiple policies, to meet the minimum requirements of Regulation H? | Yes | No |

### Escrow Requirements

- |  |     |    |
|--|-----|----|
| 1. Does the institution have policies requiring escrows for property taxes, hazard insurance, or other fees on residential buildings?            | Yes | No |
| • If it does, does the institution escrow premiums for flood insurance on those loans closed on or after October 1, 1996?                        | Yes | No |
| 2. If the institution has no specific policies regarding escrows, do its loan documents permit it to escrow for the charges mentioned in item 1? | Yes | No |
| • If they do, does the institution escrow premiums for flood insurance on those loans closed on or after October 1, 1996?                        | Yes | No |

- |  |                    |
|--|--------------------|
| <p>3. On loans closed on or after October 1, 1996, that are subject to the Real Estate Settlement Procedures Act (RESPA) and when flood insurance is required, does the institution comply with the provisions of section 10 of RESPA (section 3500.17 of HUD Regulation X) for those escrows?</p> | <p>Yes      No</p> |
|--|--------------------|

**Forced-Placement Requirements**

- |   |                                       |
|---|---------------------------------------|
| <p>1. If at any time during the life of the loan the institution determines that the security property lacks adequate flood insurance coverage,</p> <ul style="list-style-type: none"> <li>• Does the institution provide written notice to the borrower stating that the necessary coverage must be obtained within forty-five days of the notice or the institution will purchase it on the borrower's behalf?</li> <li>• Does the institution purchase the coverage on the borrower's behalf if the borrower does not obtain the required policy within the required time period?</li> </ul> | <p>Yes      No</p> <p>Yes      No</p> |
|---|---------------------------------------|

**Notice to the Director of FEMA**

- |   |                    |
|---|--------------------|
| <p>1. Does the institution provide the appropriate notice to the carrier of the insurance policy (who FEMA has designated to receive these notices) regarding the identity of the loan servicer?</p>  | <p>Yes      No</p> |
| <p>2. If the institution sells or transfers the servicing of designated loans to another party, does it have procedures in place to provide the appropriate notice to the director's designee within sixty days of the effective date of the transfer of the servicing?</p> | <p>Yes      No</p> |



# Fair Credit Reporting

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## Background

The Fair Credit Reporting Act (FCRA) deals with the rights of consumers in relation to their credit reports and the obligations of credit reporting agencies and the businesses that provide information to them. The FCRA has been revised numerous times since it took effect in 1971, notably by passage of the Consumer Credit Reporting Reform Act of 1996, the Gramm-Leach-Bliley Act of 1999, and the Fair and Accurate Credit Transactions Act of 2003 (FACT Act).

The FACT Act created new responsibilities for consumer reporting agencies and users of consumer reports, many concerning consumer disclosures and identity theft. It also created new rights for consumers, including the right to free annual consumer reports and improved access to report information, with the aim of making data in the consumer reporting system more accurate.

## Coverage

Business entities that are consumer reporting agencies have significant responsibilities under the FCRA; business entities that are not consumer reporting agencies have somewhat lesser responsibilities. Generally, financial institutions are not considered consumer reporting agencies; however, those that engage in certain types of information-sharing practices can be deemed consumer reporting agencies. In addition, the FCRA applies to financial institutions that operate as

- Procurers and users of information (for example, when granting credit, purchasing dealer paper, or opening deposit accounts),
- Furnishers and transmitters of information (by reporting information to consumer reporting agencies or other third parties, or to affiliates),
- Marketers of credit or insurance products, or
- Employers.

## Key Definitions

Key definitions used throughout the FCRA include the following:

### Consumer

A *consumer* is an individual.

## Consumer Report

A *consumer report* is any written, oral, or other communication of any information by a consumer reporting agency that bears on a consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living that is used (or is expected to be used) or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for

- Credit or insurance to be used primarily for personal, family, or household purposes;
- Employment purposes; or
- Any other purpose authorized under FCRA, section 604.

The term "consumer report" does not include

- Any report containing information solely about transactions or experiences between the consumer and the institution making the report;
- Any communication of that transaction or experience information among entities related by common ownership or affiliated by corporate control (for example, different banks that are members of the same holding company, or subsidiary companies of a bank);
- Communication of other information among persons related by common ownership or affiliated by corporate control if
  - It is clearly and conspicuously disclosed to the consumer that the information may be communicated among such persons, and
  - The consumer is given the opportunity, before the time the information is communicated, to direct that the information not be communicated among such persons;
- Any authorization or approval of a specific extension of credit directly or indirectly by the issuer of a credit card or similar device;
- Any report in which a person who has been requested by a third party to make a specific extension of credit directly or indirectly to a consumer (such as a lender who has received a request from a broker) conveys his or her decision with respect to such request, if the third party advises the consumer of the name and address of the person to whom the request was made, and such person makes the disclosures to

the consumer required under FCRA, section 615; or

- A communication described in FCRA, subsection 603(o) or (x) (which relate to certain investigative reports and certain reports to prospective employers).

## Person

A *person* is any individual, partnership, corporation, trust, estate, cooperative, association, government or governmental subdivision or agency, or other entity.

## Investigative Consumer Report

An *investigative consumer report* is a consumer report or portion thereof for which information on a consumer's character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer, or with others with whom the consumer is acquainted or who may have knowledge concerning any such information. However, such information does not include specific factual information on a consumer's credit record obtained directly from a creditor of the consumer or from a consumer reporting agency when such information was obtained directly from a creditor of the consumer or from the consumer.

## Adverse Action

With regard to credit transactions, the term *adverse action* has the same meaning as used in section 701(d)(6) of the Equal Credit Opportunity Act (ECOA), Regulation B, and the official staff commentary. Under the ECOA, an "adverse action" is a denial or revocation of credit, a change in the terms of an existing credit arrangement, or a refusal to grant credit in substantially the same amount or on terms substantially similar to those requested. Under the ECOA, the term does not include a refusal to extend additional credit under an existing credit arrangement when the applicant is delinquent or otherwise in default, or when such additional credit would exceed a previously established credit limit.

For non-credit transactions, the term has the following additional meanings for purposes of the FCRA:

- A denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of any insurance, existing or applied for, in connection with the underwriting of insurance
- A denial of employment, or any other decision for

employment purposes that adversely affects any current or prospective employee

- A denial or cancellation of, an increase in any charge for, or any other adverse or unfavorable change in the terms of any license or benefit described in FCRA, section 604(a)(3)(D)
- An action taken or determination that (1) is made in connection with an application made by, or transaction initiated by, any consumer, or in connection with a review of an account to determine whether the consumer continues to meet the terms of the account, and (2) is adverse to the interests of the consumer

## Employment Purposes

A consumer report used for *employment purposes* is a report used for the purpose of evaluating a consumer for employment, promotion, reassignment, or retention as an employee.

## Consumer Reporting Agency

A *consumer reporting agency* is any person that (1) for monetary fees, dues, or on a cooperative nonprofit basis regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information, or other information on consumers, for the purpose of furnishing consumer reports to third parties, and (2) uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports.

## Implementation of the FCRA

Some of the requirements for financial institutions imposed by the FCRA are written directly into the statute; others are contained in regulations issued jointly by the FFIEC agencies; still others are spelled out in regulations issued by the Federal Reserve Board and/or the Federal Trade Commission.

For examination purposes, similar requirements have been grouped together, creating a series of examination modules. The five modules that have been completed to date cover requirements applicable to financial institutions that are not consumer reporting agencies. A sixth module will cover institutions that are considered consumer reporting agencies. The five completed examination modules are listed below with the statutory or regulatory cites for the FCRA requirements they cover.<sup>1</sup>

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1. Other FCRA provisions—including section 628 (Disposal Rules)—are covered in other functional examinations, such as safety and soundness examinations, and therefore are not part of these procedures.

*Module 1: Obtaining Consumer Reports*

- Permissible Purposes of Consumer Reports, and Investigative Consumer Reports—FCRA, Sections 604 and 606

*Module 2: Obtaining Information and Sharing among Affiliates*

- Consumer Report and Information Sharing—FCRA, Section 603(d)
- Protection of Medical Information—FCRA, Section 604(g), and Regulation V, Sections 222.30–32
- Affiliate Marketing Opt-Out—FCRA, Section 624 and Regulation V, Section 222.20

*Module 3: Disclosures to Consumers and Miscellaneous Requirements*

- Use of Consumer Reports for Employment Purposes—FCRA, Section 604(b)
- Prescreened Consumer Reports and Opt-Out Notice—FCRA, Sections 604(c) and 615(d); FTC Regulations, Parts 642 and 698
- Truncation of Credit and Debit Card Account Numbers—FCRA, Section 605(g)
- Disclosure of Credit Scores by Certain Mortgage Lenders—FCRA, Section 609(g)
- Adverse Action Disclosures—FCRA, Sections 615(a) and (b)
- Debt Collector Communications concerning Identity Theft—FCRA, Section 615(g)
- Risk-Based Pricing Notice—FCRA, Section 615(h)

*Module 4: Duties of Users of Credit Reports and Furnishers of Consumer Report Information*

- Duties of Users of Credit Reports Regarding

Address Discrepancies—FCRA, Section 605(h)(1) and Regulation V, Section 222.82

- Furnishers of Information—General—FCRA, Section 623
- Prevention of Re-Pollution of Consumer Reports—FCRA, Section 623(a)(6)
- Negative Information Notice—FCRA, Section 623(a)(7)

*Module 5: Consumer Alerts and Identity Theft Protections*

- Fraud and Active Duty Alerts—FCRA, Section 605A(h)
- Information Available to Victims—FCRA, Section 609(e)
- Duties of Card Issuers Regarding Changes of Address—FCRA, Section 615(e)(1)(c) and Regulation V, Section 222.91

*Module 6: Requirements for Consumer Reporting Agencies***Organization of Examination Procedures**

The modules in this chapter contain both general information about each of the requirements and examination procedures. Preceding the modules are the objectives and initial procedures for fair credit reporting examinations.



# Fair Credit Reporting Examination Objectives and Initial Examination Procedures

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## EXAMINATION OBJECTIVES

1. To determine the financial institution's compliance with the FCRA
2. To assess the quality of the financial institution's compliance management systems and its policies and procedures for implementing the FCRA
3. To determine the reliance that can be placed on the financial institution's internal controls and procedures for monitoring the institution's compliance with the FCRA
4. To direct corrective action when violations of law are identified or when policies or internal controls are deficient

## INITIAL EXAMINATION PROCEDURES

The initial examination procedures are designed to acquaint examiners with the operations and processes of the institution being examined. They focus on the institution's systems, controls, policies, and procedures, including audits and previous examination findings.

The applicability of the various sections of the FCRA and the implementing regulations depends on an institution's unique operations. The functional examination requirements for an institution's FCRA responsibilities are presented topically in modules 1 through 6.

Initially, examiners should

1. Through discussions with management and a review of available information, determine whether the institution's internal controls are adequate to ensure compliance in the area under review. Consider the following:
  - a. Organization charts
  - b. Process flowcharts
  - c. Policies and procedures
  - d. Loan documentation
  - e. Checklists
  - f. Computer program documentation (for example, records that illustrate the fields and types of data reported to consumer reporting agencies, and automated records that track customer opt-outs for FCRA affiliate information sharing)
2. Review any compliance audit material, including workpapers and reports, to determine whether
  - a. The scope of the audit addresses all provisions as applicable;
  - b. Corrective actions were taken to follow up on previously identified deficiencies;
  - c. The testing includes samples covering all product types and decision centers;
  - d. The work performed is accurate;
  - e. Significant deficiencies and their causes are included in reports to management and/or to the board of directors; and
  - f. The frequency of review is appropriate.
3. Review the financial institution's training materials to determine whether
  - a. Appropriate training is provided to individuals responsible for FCRA compliance and operational procedures, and
  - b. The training is comprehensive and covers the various aspects of the FCRA that apply to the individual financial institution's operations.
4. Through discussions with management, determine which portions of the six examination modules will apply.
5. Complete appropriate examination modules; document and form conclusions regarding the quality of the financial institution's compliance management systems and compliance with the FCRA.





# Fair Credit Reporting

## Examination Module 1: Obtaining Consumer Reports

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### Overview

Consumer reporting agencies have a significant amount of personal information about consumers. This information is invaluable in assessing a consumer's creditworthiness for a variety of products and services, including loan and deposit accounts, insurance, and telephone services. Access to this information is governed by the Fair Credit Reporting Act (FCRA) to ensure that it is obtained for permissible purposes and is not used for illegitimate purposes.

The FCRA requires any prospective "user" of a consumer report—for example a lender, insurer, landlord, or employer—to have a legally permissible purpose for obtaining a report.

### Permissible Purposes of Consumer Reports (FCRA, Section 604) and Investigative Consumer Reports (FCRA, Section 606)

#### Legally Permissible Purposes

The FCRA allows a consumer reporting agency to furnish a consumer report under the following circumstances and no other:

- In response to a court order or federal grand jury subpoena
- In accordance with the written instructions of the consumer
- To a person, including a financial institution, that it has reason to believe
  - Intends to use the report in connection with a credit transaction involving the consumer (including extending, reviewing, and collecting credit);
  - Intends to use the information for employment purposes;<sup>2</sup>
  - Intends to use the information in connection with the underwriting of insurance involving the consumer;
  - Intends to use the information in connection with a determination of the consumer's eligibility for a license or other benefit granted by a governmental instrumentality that is required by

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<sup>2</sup> Use of consumer reports for employment purposes requires specific advance authorization and disclosure notices and, if applicable, adverse action notices. These issues are addressed in module 3 of these examination procedures.

law to consider an applicant's financial responsibility;

- Intends to use the information, as a potential investor or servicer or a current insurer, in connection with a valuation of, or an assessment of the credit or prepayment risks associated with, an existing credit obligation; or
- Otherwise has a legitimate business need for the information
  - a. In connection with a business transaction that is initiated by the consumer, or
  - b. To review an account to determine whether the consumer continues to meet the terms of the account
- In response to a request by the head of a state or local child support enforcement agency (or authorized appointee), if the person certifies various information to the consumer reporting agency regarding the need to obtain the report. (Generally, a financial institution that is not a consumer reporting agency is not involved in such a situation.)

#### Prescreened Consumer Reports

Users of consumer reports, such as financial institutions, are allowed to obtain prescreened consumer reports in order to make firm offers of credit or insurance to consumers, unless the consumers have elected to opt out of being included on prescreened lists. The FCRA contains many requirements, including an opt-out notice requirement, when prescreened consumer reports are used. In addition to defining prescreened consumer reports, module 3 covers these requirements.

#### Investigative Consumer Reports

FCRA, section 606, contains specific requirements concerning the use of investigative consumer reports. Such reports contain information about a consumer's character, general reputation, personal characteristics, or mode of living that is obtained in whole or in part through personal interviews with the consumer's neighbors, friends, or associates. If a financial institution procures an investigative consumer report, or causes one to be prepared, the institution must meet the following requirements:

- The institution must clearly and accurately disclose to the consumer that an investigative consumer report may be obtained.
- The disclosure must contain a statement of the

consumer's right to request other information about the report and a summary of the consumer's rights under the FCRA.

- The disclosure must be in writing and must be mailed or otherwise delivered to the consumer not later than three business days after the date on which the report was first requested.
- The financial institution procuring the report must certify to the consumer reporting agency that it has complied with the disclosure requirements and will comply in the event that the consumer requests additional disclosures about the report.

able information and the growth of identity theft, financial institutions should manage the risks associated with obtaining and using consumer reports. They should employ procedures, controls, or other safeguards to ensure that consumer reports are obtained and used only in situations for which there are permissible purposes. Access to, storage of, and destruction of this information should be dealt with under an institution's information-security program; however, obtaining consumer reports initially must be done in compliance with the FCRA.

### Institution Procedures

Given the preponderance of electronically avail-

# Fair Credit Reporting—Module 1

## Examination Procedures

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### Permissible Purposes of Consumer Reports (FCRA, Section 604) and Investigative Consumer Reports (FCRA, Section 606)

1. Determine whether the financial institution obtains consumer reports.
2. Determine whether the financial institution obtains prescreened consumer reports and/or reports for employment purposes. If it does, complete the appropriate sections of module 3.
3. Determine whether the financial institution procures, or causes to be prepared, investigative consumer reports. If it does, determine whether the appropriate disclosure is given to consumers within the required time periods. In addition, determine whether the institution certifies compliance with the disclosure requirements to the consumer reporting agency.
4. Evaluate the financial institution's procedures to ensure that consumer reports are obtained only for permissible purposes. Confirm that the institution certifies to the consumer reporting

agency the purposes for which it will obtain reports. (The certification is usually contained in the institution's contract with the consumer reporting agency.)

5. If procedural weaknesses or other risks requiring further investigation are noted, such as the receipt of several consumer complaints, review a sample of consumer reports obtained from a consumer reporting agency and determine whether the financial institution had permissible purposes for obtaining the reports. For example,
  - Obtain a copy of a billing statement or other list of consumer reports obtained by the financial institution from the consumer reporting agency over a period of time.
  - Compare this list, or a sample from this list, with the institution's records to ensure that there was a permissible purpose for obtaining the report(s)—for instance, the consumer applied for credit, insurance, or employment. The institution may also obtain a report in connection with the review of an existing account.



# Fair Credit Reporting

## Examination Module 2: Obtaining Information and Sharing among Affiliates

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### Overview

The Fair Credit Reporting Act (FCRA) sets forth many substantive compliance requirements for consumer reporting agencies that are designed to help ensure the accuracy and integrity of the consumer reporting system. As noted in the first section of this FCRA chapter, a consumer reporting agency is a person that generally furnishes consumer reports to third parties. By their very nature, banks, credit unions, and thrifts hold a significant amount of consumer information that could constitute a consumer report. Communication of this information could cause the institution to become a consumer reporting agency. The FCRA contains several exceptions that enable a financial institution to communicate this type of information, within strict guidelines, without becoming a consumer reporting agency.

Rather than containing strict information-sharing prohibitions, the FCRA creates a business disincentive such that if a financial institution shares consumer report information outside of the exceptions, the institution becomes a consumer reporting agency and is subject to the significant, substantive requirements of the FCRA applicable to those entities. Typically, a financial institution will structure its information-sharing practices within the exceptions to avoid becoming a consumer reporting agency. This examination module generally covers the information-sharing practices within these exceptions.

If upon completion of this module, examiners determine that the financial institution's information-sharing practices fall outside of these exceptions, the institution may be considered a consumer reporting agency, and the examination procedures in module 6 should be completed.

### Consumer Report and Information Sharing (FCRA, Section 603(d))

FCRA, section 603(d), defines a consumer report to include information about a consumer that bears on a consumer's creditworthiness, character, and credit capacity, among other characteristics. Communication of this information may cause a person, including a financial institution, to become a consumer reporting agency. The statutory definition contains key exceptions to this definition that enable a financial institution to share this type of information under certain circumstances without becoming a consumer reporting agency. Specifi-

cally, the term "consumer report" does not include the following:

- A report containing information solely related to transactions or experiences between the consumer and the financial institution making the report. A person, including a financial institution, may share information strictly related to its own transactions or experiences with a consumer (such as the consumer's record with a loan or savings account at an institution) with any third party, without regard to affiliation, without becoming a consumer reporting agency. This type of information sharing may, however, be restricted under the Privacy of Consumer Financial Information regulations that implement the Gramm-Leach-Bliley Act (GLBA) because the information meets the definition of nonpublic personal information under the Privacy regulations; sharing it with nonaffiliated third parties may be subject to opt-out provisions under the Privacy regulations. In turn, the FCRA may restrict activities that the GLBA permits. For example, the GLBA permits a financial institution to share lists of its customers and information about those customers, such as their credit scores, with another financial institution for the purpose of jointly marketing or sponsoring other financial products or services. Such a communication may be considered a consumer report under the FCRA and could cause the sharing institution to become a consumer reporting agency.
- Communication of such transaction or experience information among persons, including financial institutions, related by common ownership or affiliated by corporate control.
- Communication of other information (that is, other than transaction or experience information) among persons, including financial institutions, related by common ownership or affiliated by corporate control (1) if it is clearly and conspicuously disclosed to the consumer that the information will be communicated among such entities and (2) if, before the information is initially communicated, the consumer is given the opportunity to opt out of the communication. Thus, a financial institution is allowed to share information (other than information about its own transactions or experiences) that could otherwise constitute a consumer report without becoming a consumer reporting agency under the following circumstances:
  - The sharing of the "other" information is done with affiliates

- Consumers are provided with the notice and an opportunity to opt out of this sharing before the information is first communicated among affiliates

“Other” information can include, for example, information provided by a consumer on an application form concerning accounts with other financial institutions. It can also include information obtained by a financial institution from a consumer reporting agency, such as the consumer’s credit score. If a financial institution shares other information with affiliates without providing a notice and an opportunity to opt out, the institution may become a consumer reporting agency subject to the FCRA requirements.

The opt-out right required by this section must be stated in a financial institution’s privacy notice, as required by the GLBA and its implementing regulations.

## Other Exceptions

### Specific Extensions of Credit

In addition, the term “consumer report” does not include the communication of a specific extension of credit directly or indirectly by the issuer of a credit card or similar device. For example, this exception allows a lender to communicate an authorization through a credit card network to a retailer, to enable a consumer to complete a purchase using a credit card.

### Credit Decision to Third Party

The term “consumer report” also does not include any report in which a person, including a financial institution, that has been requested by a third party (such as an automobile dealer) to make a specific extension of credit directly or indirectly to a consumer conveys the decision with respect to the request. The third party must advise the consumer of the name and address of the financial institution to which the request was made, and the financial institution must make the adverse action disclosures when required by FCRA, section 615. For example, this exception allows a lender to communicate a credit decision to an automobile dealer that is arranging financing for the purchase of an automobile by a consumer who requires a loan to finance the transaction.

### “Joint User” Rule

The Federal Trade Commission staff commentary discusses another exception, known as the Joint User Rule. Under this exception, users of con-

sumer reports, including financial institutions, may share information with each other if they are jointly involved in the decision to approve a consumer’s request for a product or service, provided that each has a permissible purpose for obtaining a consumer report on the individual. For example, a consumer applies for a mortgage loan that will have a high loan-to-value ratio, and thus the lender will require private mortgage insurance (PMI) in order to approve the application. The PMI will be provided by an outside company. The lender and the PMI company may share consumer report information about the consumer because both entities have permissible purposes for obtaining the information and they are jointly involved in the decision to grant products to the consumer.

This exception applies both to entities that are affiliated and to nonaffiliated third parties. It is important to note that the GLBA still applies to the sharing of nonpublic personal information with nonaffiliated third parties; therefore, financial institutions should be aware that sharing under the FCRA Joint User Rule may still be limited or prohibited by the GLBA.

## Protection of Medical Information (FCRA, Section 604(g); and Regulation V, Subpart D)

Section 604(g) generally prohibits creditors from obtaining and using medical information in connection with any determination of the consumer’s eligibility, or continued eligibility, for credit. The statute contains no prohibition regarding creditors’ obtaining or using medical information for other purposes that are not in connection with a determination of the consumer’s eligibility, or continued eligibility, for credit.

Section 604(g)(5)(A) required the FFIEC agencies to prescribe regulations that permit transactions determined to be necessary and appropriate to protect legitimate operational, transactional, risk, consumer, and other needs (including administrative verification purposes) and that are consistent with the congressional intent to restrict the use of medical information for inappropriate purposes. The agencies published final rules in the *Federal Register* (70 FR 70664) on November 22, 2005; subpart D of Regulation V implements the requirements for entities supervised by the Federal Reserve. The rules contain the general prohibition regarding obtaining or using medical information and provide exceptions for the limited circumstances under which medical information may be used. The rules define “credit” and “creditor” as having the same meanings as in section 702 of the Equal Credit Opportunity Act.

### Obtaining and Using Unsolicited Medical Information (Regulation V, § 222.30(c))

A creditor does not violate the prohibition on obtaining medical information if it receives the medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit without specifically requesting medical information. However, the creditor may use this medical information only in connection with a determination of the consumer's eligibility, or continued eligibility, for credit in accordance with either the financial information exception or one of the specific other exceptions provided in the rules. These exceptions are discussed below.

### Financial Information Exception (Regulation V, § 222.30(d))

A creditor is allowed to obtain and use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit, so long as all of the following conditions are met:

- The information is the type of information routinely used in making credit eligibility determinations, such as information relating to debts, expenses, income, benefits, assets, collateral, or the purpose of the loan, including the use of the loan proceeds.
- The creditor uses the medical information in a manner and to an extent that is no less favorable than it would use comparable information that is not medical information in a credit transaction.
- The creditor does not take the consumer's physical, mental, or behavioral health, condition or history, type of treatment, or prognosis into account as part of any such determination.

The financial information exception is designed in part to allow a creditor to consider a consumer's medical debts and expenses in the assessment of that consumer's ability to repay the loan according to the loan terms. The financial information exception also allows a creditor to consider the dollar amount and continued eligibility for disability income, worker's compensation income, or other benefits related to health or a medical condition that is relied on as a source of repayment.

The creditor may use the medical information in a manner and to an extent that is *no less favorable* than it would use comparable nonmedical information. For example, a consumer includes on an application for credit information about two \$20,000 debts. One debt is to a hospital; the other is to a retailer. The creditor may use and consider the debt

to the hospital in the same manner in which it considers the debt to the retailer, such as including the debts in the calculation of the consumer's proposed debt-to-income ratio. In addition, the consumer's history of payment of the debt to the hospital may be considered in the same manner as payment of the debt to the retailer. For example, if the creditor does not grant loans to applicants who have debts that are ninety days past due, the creditor could consider the past-due status of a debt to the hospital in the same manner as it considers the past-due status of a debt to the retailer.

A creditor may use medical information in a manner that is more favorable to the consumer, according to its regular policies and procedures. For example, if a creditor has a routine policy of declining consumers who have a ninety-day past-due installment loan to a retailer but does not decline consumers who have a ninety-day past-due debt to a hospital, the financial information exception would allow the creditor to continue this policy without violating the rules, because in such a case, the creditor's treatment of the hospital debt is more favorable to the consumer.

A creditor may not take the consumer's physical, mental, or behavioral health, condition or history, type of treatment, or prognosis into account as part of any determination regarding the consumer's eligibility, or continued eligibility, for credit. The creditor may consider only the financial implications as discussed above, such as the status of a debt to a hospital or the continuance of disability income.

### Specific Exceptions for Obtaining and Using Medical Information (Regulation V, § 222.30(e))

In addition to the financial information exception, the rules provide for the following nine specific exceptions under which a creditor may obtain and use medical information in its determination of the consumer's eligibility, or continued eligibility, for credit:

1. To determine whether the use of a power of attorney or legal representative that is triggered by a medical condition or event is necessary and appropriate, or whether the consumer has the legal capacity to contract when a person seeks to exercise a power of attorney or act as a legal representative for a consumer on the basis of an asserted medical condition or event. For example, if person A is attempting to act on behalf of person B under a power of attorney that is invoked on the basis of a medical event, a creditor is allowed to obtain and use medical information to verify that person B has experienced a medical condition or event such that



- person A is allowed to act under the power of attorney.
2. To comply with applicable requirements of local, state, or federal laws
  3. To determine, at the consumer's request, whether the consumer qualifies for a legally permissible special credit program or credit-related assistance program that is
    - Designed to meet the special needs of consumers with medical conditions, and
    - Established and administered pursuant to a written plan that
      - Identifies the class of persons that the program is designed to benefit, and
      - Sets forth the procedures and standards for extending credit or providing other credit-related assistance under the program
  4. To the extent necessary for purposes of fraud prevention or detection
  5. In the case of credit for the purpose of financing medical products or services, to determine and verify the medical purpose of the loan and the use of the proceeds
  6. Consistent with safe and sound banking practices, if the consumer or the consumer's legal representative requests that the creditor use medical information in determining the consumer's eligibility, or continued eligibility, for credit to accommodate the consumer's particular circumstances, and such request is documented by the creditor. For example, at the consumer's request, a creditor may grant an exception to its ordinary policy to accommodate a medical condition that the consumer has experienced. This exception allows a creditor to consider medical information in this context, but it does not require a creditor to make such an accommodation, nor does it require a creditor to grant a loan that is unsafe or unsound.
  7. Consistent with safe and sound practices, to determine whether the provisions of a forbearance practice or program that is triggered by a medical condition or event apply to a consumer. For example, if a creditor has a policy of delaying foreclosure in cases in which a consumer is experiencing a medical hardship, this exception allows the creditor to use medical information to determine if the policy would apply to the consumer. Like exception 6 above, this exception does not require a creditor to grant forbearance; it merely provides an exception so that a creditor may consider medical information in these instances.
  8. To determine the consumer's eligibility for, the

triggering of, or the reactivation of a debt-cancellation contract or debt-suspension agreement if a medical condition or event is a triggering event for the provision of benefits under the contract or agreement

9. To determine the consumer's eligibility for, the triggering of, or the reactivation of a credit insurance product if a medical condition or event is a triggering event for the provision of benefits under the product

### Limits on Redisclosure of Information (Regulation V, § 222.31(b))

If a creditor subject to the medical information rules receives medical information about a consumer from a consumer reporting agency or its affiliate, the creditor must not disclose that information to any other person, except as necessary to carry out the purpose for which the information was initially disclosed or as otherwise permitted by statute, regulation, or order.

### Sharing Medical Information with Affiliates (Regulation V, § 222.32(b))

In general, the exclusions from the definition of "consumer report" in FCRA, section 603(d)(2), allow the sharing of information among affiliates. With regard to medical information, FCRA, section 603(d)(3), provides that the exclusions in section 603(d)(2) do not apply when a person subject to the medical information rules shares information of the following types with an affiliate:

- Medical information
- An individualized list or description based on the payment transactions of the consumer for medical products or services
- An aggregate list of identified consumers based on payment transactions for medical products or services

If a person that is subject to the medical rules shares with an affiliate information of one of the types listed above, the exclusions from the definition of "consumer report" do not apply. Effectively, this means that if a person shares medical information, that person becomes a consumer reporting agency, subject to all the other substantive requirements of the FCRA.

The rules provide exceptions to these limitations on sharing medical information with affiliates (Regulation V, section 222.32(c)). A covered entity, such as a state member bank, may share medical information with its affiliates without becoming a consumer reporting agency under one or more of

the following circumstances:

- In connection with the business of insurance or annuities (including the activities described in section 18B of the model Privacy of Consumer Financial and Health Information Regulation issued by the National Association of Insurance Commissioners, as in effect on January 1, 2003)
- For any purpose permitted without authorization under the regulations issued by the Department of Health and Human Services pursuant to the Health Insurance Portability and Accountability Act of 1996 (HIPAA)
- For any purpose referred to in section 1179 of HIPAA
- For any purpose described in section 502(e) of the Gramm-Leach-Bliley Act
- In connection with a determination of the consumer's eligibility, or continued eligibility, for credit consistent with the financial information exceptions or specific exceptions
- As otherwise permitted by order of an FFIEC agency

### Affiliate Marketing Opt-Out (Regulation V, § 222.20)

Section 624 gives a consumer the right to restrict an entity, with which it does not have a pre-existing business relationship, from *using* certain information obtained from an affiliate to make solicitations to that consumer. This provision is distinct from section 603(d)(2)(A)(iii) which gives a consumer the right to restrict the *sharing* of certain consumer information amongst affiliates.<sup>3</sup>

Under section 624, an entity may not use information received from an affiliate to market its products or services to a consumer, unless the consumer is given notice and a reasonable opportunity and a reasonable and simple method to opt out of the making of such solicitations. The affiliate marketing opt-out applies to information that an entity has obtained from transactions or its experience with a consumer. The opt-out also applies to "other" information, such as information the entity obtains about a consumer from credit reports and credit applications. On November 7, 2007, the federal financial institution regulators published final regulations in the Federal Register to imple-

ment this section (72 FR 62910).<sup>4</sup>

Exceptions to the notice and opt-out requirements apply when an entity uses eligibility information in certain ways, as described later in these procedures.

### Key Definitions (Regulation V, § 222.20)<sup>5</sup>

1. *Eligibility information* (12 CFR 222.20(b)(3)) includes not only transaction and experience information, but also the type of information found in consumer reports, such as information from third-party sources and credit scores. Eligibility information does not include aggregate or blind data that does not contain personal identifiers such as account numbers, names, or addresses.<sup>6</sup>
2. *Pre-existing business relationship* (12 CFR 222.20(b)(4))<sup>7</sup> means a relationship between a person, such as a financial institution (or a person's licensed agent), and a consumer based on
  - a. A financial contract between the person and the consumer which is in force on the date on which the consumer is sent a solicitation covered by the affiliate marketing regulation;
  - b. The purchase, rental, or lease by the consumer of the person's goods or services, or a financial transaction (including holding an active account or a policy in force, or having another continuing relationship) between the consumer and the person, during the 18-month period immediately preceding the date on which the consumer is sent a solicitation covered by the affiliate marketing regulation; or
  - c. An inquiry or application by the consumer regarding a product or service offered by that person during the three-month period immediately preceding the date on which the consumer is sent a solicitation covered by the affiliate marketing regulation.
3. *Solicitation* (12 CFR 222.20(b)(5)) means the marketing of a product or service initiated by a person, such as a financial institution, to a particular consumer that is

4. See 12 CFR 222.20(a) for the scope of entities covered by Subpart C of 12 CFR 222.

5. See 12 CFR 222.20 for other definitions.

6. Specifically, "eligibility information" is defined in the affiliate marketing regulation as "any information the communication of which would be a consumer report if the exclusions from the definition of 'consumer report' in Section 603(d)(2)(A) of the [Fair Credit Reporting] Act did not apply."

7. See 12 CFR 222.20(b)(4)(ii) and (iii) for examples of pre-existing business relationships and situations where no pre-existing business relationship exists.

3. See Module 2, Consumer Report and Information Sharing (Section 603(d)), for provisions pertaining to the sharing of consumer information. Under section 603(d)(2)(A)(iii) of the FCRA, entities are responsible for complying with the affiliate *sharing* notice and opt-out requirement, where applicable. Thus, under the FCRA, certain consumer information will be subject to two opt-outs, a sharing opt-out (section 603(d)) and a marketing use opt-out (section 624). These two opt-outs may be consolidated.

- a. Based on eligibility information communicated to that person by its affiliate, and
- b. Intended to encourage the consumer to purchase or obtain such product or service.

Examples of a solicitation include a telemarketing call, direct mail, e-mail, or other form of marketing communication directed to a particular consumer that is based on eligibility information received from an affiliate. A solicitation *does not* include marketing communications that are directed at the general public (for example, television, general circulation magazine, and billboard advertisements).

### Initial Notice and Opt-Out Requirement (Regulation V, §§ 222.21(a), 222.24, and 222.25)

A financial institution and its subsidiaries (“financial institution”) generally may not use eligibility information about a consumer that it receives from an affiliate to make a solicitation for marketing purposes to the consumer, unless

1. It is clearly and conspicuously disclosed to the consumer in writing or, if the consumer agrees, electronically, in a concise notice that the financial institution may use eligibility information about that consumer that it received from an affiliate to make solicitations for marketing purposes to the consumer;
2. The consumer is provided a reasonable opportunity and a reasonable and simple method to “opt out” (that is, the consumer prohibits the financial institution from using eligibility information to make solicitations for marketing purposes to the consumer);<sup>8</sup> and
3. The consumer has not opted out.

For example, a consumer has a homeowner’s insurance policy with an insurance company. The insurance company shares eligibility information about the consumer with its affiliated depository institution. Based on that eligibility information, the depository institution wants to make a solicitation to the consumer about its home equity loan products. The depository institution does not have a pre-existing business relationship with the consumer and none of the other exceptions apply. The depository institution may not use eligibility information it received from its insurance affiliate to make solicitations to the consumer about its home equity loan products unless the insurance company gave the consumer a notice and opportunity to opt out and the consumer does not opt out.

<sup>8</sup> See 12 CFR 222.24 and 222.25 for examples of “a reasonable opportunity to opt out” and “reasonable and simple methods for opting out.”

### Making Solicitations (Regulation V, § 222.21(b))<sup>9</sup>

A financial institution (or a service provider acting on behalf of the financial institution) makes a solicitation for marketing purposes if

1. The financial institution receives eligibility information from an affiliate, including when the affiliate places that information into a common database that the financial institution may access;
2. The financial institution uses that eligibility information to do one or more of the following:
  - a. Identify the consumer or type of consumer to receive a solicitation;
  - b. Establish criteria used to select the consumer to receive a solicitation; or
  - c. Decide which of the financial institution’s products or services to market to the consumer or tailor the financial institution’s solicitation to that consumer; and
3. As a result of the financial institution’s use of the eligibility information, the consumer is provided a solicitation.

A financial institution does *not* make a solicitation for marketing purposes (and therefore the affiliate marketing regulation, with its notice and opt-out requirements, does not apply) in the situations listed below, commonly referred to as “constructive sharing.” Constructive sharing occurs when a financial institution provides criteria to an affiliate to use in marketing the financial institution’s product and the affiliate uses the criteria to send marketing materials to the affiliate’s own customers that meet the criteria. In this situation, the financial institution is not *using* shared eligibility information to make solicitations.

1. The financial institution provides criteria for consumers to whom it would like its affiliate to market the financial institution’s products. Then, based on this criteria, the affiliate uses eligibility information that the affiliate obtained in connection with its own pre-existing business relationship with the consumer to market the financial institution’s products or services (or directs its service provider to use the eligibility information in the same manner and the financial institution does not communicate with the service provider regarding that use).
2. A service provider, applying the financial institution’s criteria, uses information from an affiliate, such as that in a shared database, to market the financial institution’s products or services to the

<sup>9</sup> See 12 CFR 222.21(b)(6) for examples of making solicitations.

consumer, so long as it meets certain requirements, including

- a. The affiliate controls access to, and use of, its eligibility information by the service provider under a written agreement between the affiliate and the service provider;
- b. The affiliate establishes, in writing, specific terms and conditions under which the service provider may access and use the affiliate's eligibility information to market the financial institution's products and services (or those of affiliates generally) to the consumer;
- c. The affiliate requires the service provider, under a written agreement, to implement reasonable policies and procedures designed to ensure that the service provider uses the affiliate's eligibility information in accordance with the terms and conditions established by the affiliate relating to the marketing of the financial institution's products or services;
- d. The affiliate is identified on or with the marketing materials provided to the consumer; and
- e. The financial institution does not directly use its affiliate's eligibility information in the manner described above under "Making Solicitations (Regulation V, § 222.21(b)),” item 2.

### Exceptions to Initial Notice and Opt-out Requirements (Regulation V, § 222.21(c))<sup>10</sup>

The initial notice and opt-out requirements do not apply to a financial institution if it uses eligibility information that it receives from an affiliate

1. To make a solicitation for marketing purposes to a consumer with whom the financial institution has a pre-existing business relationship;
2. To facilitate communications to an individual for whose benefit the financial institution provides employee benefit or other services pursuant to a contract with an employer;
3. To perform services on behalf of an affiliate (but this would not allow solicitation where the consumer has opted out);
4. In response to a communication about the financial institution's products or services initiated by the consumer;
5. In response to a consumer's authorization or

<sup>10</sup>. See 12 CFR 222.21(d) for examples of exceptions to the initial notice and opt-out requirement.

request to receive solicitations; or

6. If the financial institution's compliance with the affiliate marketing regulation would prevent it from complying with State insurance laws pertaining to unfair discrimination in any state in which the financial institution is lawfully doing business.

### Contents of Opt-out Notice (Regulation V, § 222.23)

A financial institution must provide to the consumer a reasonable and simple method for the consumer to opt out. The opt-out notice must be clear, conspicuous, and concise, and must accurately disclose specific information outlined in 12 CFR 222.23(a), including that the consumer may elect to limit the use of eligibility information to make solicitations to the consumer. See Appendix C to the regulation for the model notices contained in the affiliate marketing regulation.

*Alternative contents.* An affiliate that provides a consumer a broader right to opt out than that required by the affiliate marketing regulation may satisfy the regulatory requirements by providing the consumer with a clear, conspicuous, and concise notice that accurately discloses the consumer's opt-out rights.

*Coordinated, consolidated, and equivalent notices.* Opt-out and renewal notices may be coordinated and consolidated with any other notice or disclosure required under any other provision of law, such as the Gramm-Leach-Bliley Act (GLBA), 15 USC 6801 et seq. Renewal notices, which have additional required content (12 CFR 222.27), may be consolidated with the annual GLBA privacy notices.

### Delivery of the Opt-Out Notice (Regulation V, §§ 222.21(a)(3) and 222.26)<sup>11</sup>

An affiliate that has or previously had a pre-existing business relationship with the consumer must provide the notice either individually or as part of a joint notice from two or more members of an affiliated group of companies. The opt-out notice must be provided so that each consumer can reasonably be expected to receive actual notice. A consumer may *not* reasonably be expected to receive actual notice if, for example, the affiliate providing the notice sends the notice via e-mail to a consumer who has not agreed to receive electronic

<sup>11</sup>. See 12 CFR 222.26(b) and (c) for examples of "reasonable expectation of actual notice" and "no reasonable expectation of actual notice."

disclosures by e-mail from the affiliate providing the notice.<sup>12</sup>

### Scope of Opt-Out (Regulation V, §§ 222.22(a) and 222.23(a)(2))<sup>13</sup>

As a general rule, the consumer's election to opt out prohibits any affiliate covered by the opt-out notice from using eligibility information received from another affiliate, described in the notice, to make solicitations to the consumer. If two or more consumers jointly obtain a product or service, any of the joint consumers may exercise the right to opt out. It is impermissible to require all joint consumers to opt out before implementing any opt-out direction.

*Menu of alternatives.* A consumer may be given the opportunity to choose from a menu of alternatives when electing to prohibit solicitations, such as by

1. Electing to prohibit solicitations from certain types of affiliates covered by the opt-out notice but not other types of affiliates covered by the notice,
2. Electing to prohibit solicitations based on certain types of eligibility information but not other types of eligibility information, or
3. Electing to prohibit solicitations by certain methods of delivery but not other methods of delivery.

One of the alternatives, however, must allow the consumer to prohibit all solicitations from all of the affiliates that are covered by the notice.

*Continuing relationship.* If the consumer establishes a continuing relationship with a financial institution or its affiliate, an opt-out notice may apply to eligibility information obtained from one or more continuing relationships (such as a deposit account, a mortgage loan, or a credit card), if the notice adequately describes the continuing relationships covered. The opt-out notice can also apply to future continuing relationships if the notice adequately describes the continuing future relationships that would be covered.

*Special rule for a notice following termination of all continuing relationships.* After all continuing relationships with a financial institution or its affiliate(s) are terminated, a consumer must be given a new opt-out notice if the consumer later establishes another continuing relationship with the financial institution or its affiliate(s) and the consum-

er's eligibility information is to be used to make a solicitation. The consumer's decision not to opt out after receiving the new opt-out notice would not override a prior opt-out election that applies to eligibility information obtained in connection with a terminated relationship.

*No continuing relationship (isolated transaction).* If the consumer does not establish a continuing relationship with a financial institution or its affiliate, but the financial institution or its affiliate obtains eligibility information about the consumer in connection with a transaction with the consumer (such as an ATM cash withdrawal, purchase of traveler's checks, or a credit application that is denied), an opt-out notice provided to the consumer only applies to eligibility information obtained in connection with that transaction.

### Time, Duration, and Renewal of Opt-Out (Regulation V, §§ 222.22(b) and (c) and 222.27)

A consumer may opt out at any time. The opt-out must be effective for a period of at least five years beginning when the consumer's opt-out election is received and implemented, unless the consumer later revokes the opt-out in writing or, if the consumer agrees, electronically. An opt-out period may be set at more than five years, including an opt-out that does not expire unless the consumer revokes it.

*Renewal after opt-out period expires.* After the opt-out period expires, a financial institution may not make solicitations based on eligibility information it receives from an affiliate to a consumer who previously opted out, unless

1. The consumer receives a renewal notice and opportunity to opt out, and the consumer does not renew the opt-out; or
2. An exception to the notice and opt-out requirements applies.<sup>14</sup>

*Contents of renewal notice.* The renewal notice must be clear, conspicuous, and concise, and must accurately disclose most of the elements of the original opt-out notice, as well as the facts that

1. The consumer previously elected to limit the use of certain information to make solicitations to the consumer;
2. The consumer's election has expired or is about to expire;
3. The consumer may elect to renew the consumer's previous election; and
4. If applicable, that the consumer's election to

12. For opt-out notices provided electronically, the notice may be provided in compliance with either the electronic disclosure provisions of 12 CFR 222.24(b)(2) and 222.24(b)(3) or the provisions in section 101 of the Electronic Signatures in Global and National Commerce Act, 15 USC 7001 et seq.

13. See 12 CFR 222.22(a) for examples of the scope of the opt-out, including examples of continuing relationships.

14. See 12 CFR 222.21(c) for exceptions.

renew will apply for the specified period of time stated in the notice and that the consumer will be allowed to renew the election once that period expires.

See 12 CFR 222.27(b) for all the content requirements of renewal notice.

*Renewal period.* Each opt-out renewal must be effective for a period of at least five years.

*Affiliate who may provide the notice.* The renewal notice must be provided by the affiliate that provided the previous opt-out notice, or its successor; or as part of a joint renewal notice from two or more members of an affiliated group of companies, or their successors, that jointly provided the previous opt-out notice.

*Timing of the renewal notice.* A renewal notice may be provided to the consumer either at a reasonable period of time before the expiration of the opt-out period<sup>15</sup> or at any time after the expiration of the opt-out period but before solicitations that would have been prohibited by the expired opt-out are made to the consumer.

### Prospective Application (Regulation V, § 222.28(c))

A financial institution may use eligibility information received from an affiliate to make solicitations to a consumer if it received such information prior to

<sup>15</sup> An opt-out period may not be shortened by sending a renewal notice to the consumer before expiration of the opt-out period, even if the consumer does not renew the opt-out. If a financial institution provides an annual privacy notice under the Gramm-Leach-Bliley Act, providing a renewal notice with the last annual privacy notice provided to the consumer before expiration of the opt-out period is a reasonable period of time before expiration of the opt-out in all cases. 12 CFR 222.27(d)

October 1, 2008, the mandatory compliance date of the affiliate marketing regulation. An institution is deemed to have received eligibility information when such information is placed into a common database and is accessible by the institution prior to that date.

### Model Forms for Opt-Out Notices (Regulation V, § 222, Appendix C)

Appendix C of the affiliate marketing regulation contains model forms that may be used to comply with the requirement for clear, conspicuous, and concise notices. The five model forms are

- C-1 Model Form for Initial Opt-out Notice (Single-Affiliate Notice)
- C-2 Model Form for Initial Opt-out Notice (Joint Notice)
- C-3 Model Form for Renewal Notice (Single-Affiliate Notice)
- C-4 Model Form for Renewal Notice (Joint Notice)
- C-5 Model Form for Voluntary “No Marketing” Notice

Use of the model forms is not required and a financial institution may make certain changes to the language or format of the model forms without losing the protection from liability afforded by use of the model forms. These changes may not be so extensive as to affect the substance, clarity, or meaningful sequence of the language in the model forms. Institutions making such extensive revisions will lose the “safe harbor” that Appendix C provides. Examples of acceptable changes are provided in Appendix C to the regulation.



# Fair Credit Reporting—Module 2

## Examination Procedures

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### Consumer Report and Information Sharing (FCRA, Section 603(d))

1. Review the financial institution's policies, procedures, and practices concerning the sharing of consumer information with third parties, including both affiliated and nonaffiliated third parties. Determine the type of information shared and with whom the information is shared. (This portion of the examination may overlap with a review of the institution's compliance with Regulation P, Privacy of Consumer Financial Information, which implements the Gramm-Leach-Bliley Act.)
2. Determine whether the financial institution's information-sharing practices fall within the exceptions to the definition of a consumer report. If they do not, the financial institution could be considered a consumer reporting agency, in which case the examination procedures in module 6 should be completed.
3. If the financial institution shares information other than transaction and experience information with affiliates subject to opt-out provisions, determine whether the institution's GLBA privacy notice contains information regarding how to opt out, as required by Regulation P.
4. If procedural weaknesses or other risks requiring further investigation are noted, obtain a sample of opt-out rights exercised by consumers and determine whether the financial institution honored the opt-out requests by not sharing "other information" about those consumers with the institution's affiliates after receiving the opt-out requests.

### Protection of Medical Information (FCRA, Section 604(g); and Regulation V, Subpart D)

1. Review the financial institution's policies, procedures, and practices concerning the collection and use of consumer medical information in connection with any determination of the consumer's eligibility, or continued eligibility, for credit.
2. If the financial institution's policies, procedures, and practices allow for obtaining and using consumer medical information in the context of a credit transaction, determine whether there are adequate controls in place to ensure that the information is used only subject to the financial information exception or one of the specific

exceptions set forth in Regulation V.

3. If procedural weaknesses or other risks requiring further investigation are noted, obtain samples of credit transactions to determine whether the use of consumer medical information was done strictly under the financial information exception or one of the specific exceptions in Regulation V.
4. Determine whether the financial institution has adequate policies and procedures in place to limit the redisclosure of consumer medical information that was received from a consumer reporting agency or an affiliate.
5. Determine whether the financial institution shares medical information about a consumer with its affiliates. If it does, determine whether the sharing occurred in accordance with an exception in Regulation V that enables the institution to share the information without becoming a consumer reporting agency.

### Affiliate Marketing Opt-Out (FCRA, Section 624; and Regulation V, Section 222.20)

1. Determine whether the financial institution receives consumer eligibility information from an affiliate. Stop here if it does not because Subpart C of 12 CFR 222 does not apply.
2. Determine whether the financial institution uses consumer eligibility information received from an affiliate to make a solicitation for marketing purposes that is subject to the notice and opt-out requirements. If it does not, stop here.
3. Evaluate the institution's policies, procedures, practices, and internal controls to ensure that, where applicable, the consumer is provided with an appropriate notice, a reasonable opportunity, and a reasonable and simple method to opt out of the institution's using eligibility information to make solicitations for marketing purposes to the consumer, and that the institution is honoring the consumer's opt-outs.
4. If compliance risk management weaknesses or other risks requiring further investigation are noted, obtain and review a sample of notices to ensure technical compliance and a sample of opt-out requests from consumers to determine if the institution is honoring the opt-out requests.
  - a. Determine whether the opt-out notices are clear, conspicuous, and concise and contain



the required information, including the name of the affiliate(s) providing the notice, a general description of the types of eligibility information that may be used to make solicitations to the consumer, and the duration of the opt out. (12 CFR 222.23(a))

- b. Review opt-out notices that are coordinated and consolidated with any other notice or disclosure that is required under other provisions of law for compliance with the affiliate marketing regulation. (12 CFR 222.23(b))
- c. Determine whether the opt-out notices and renewal notices provide the consumer a

reasonable opportunity to opt out and a reasonable and simple method to opt out. (12 CFR 222.24 and 222.25)

- d. Determine whether the opt-out notice and renewal notice are provided (by mail delivery or electronically) so that a consumer can reasonably be expected to receive that actual notice. (12 CFR 222.26)
- e. Determine whether, after an opt-out period expires, a financial institution provides a consumer a renewal notice prior to making solicitations based on eligibility information received from an affiliate. (12 CFR 222.27)

# Fair Credit Reporting

## Examination Module 3: Disclosures to Consumers and Miscellaneous Requirements

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### Overview

The Fair Credit Reporting Act (FCRA) requires financial institutions to provide consumers with various notices and information under a variety of circumstances. This module deals with examination responsibilities for these various areas.

### Use of Consumer Reports for Employment Purposes (FCRA, Section 604(b))

FCRA, section 604(b), sets forth specific requirements for financial institutions that obtain consumer reports on its employees or prospective employees prior to, and/or during, the term of employment. The FCRA generally requires the written permission of the consumer to procure a consumer report for “employment purposes.” Moreover, a clear and conspicuous disclosure that a consumer report may be obtained for employment purposes must be provided in writing to the consumer prior to procuring a report.

Prior to taking any adverse action involving employment that is based in whole or in part on the consumer report, the user generally must provide to the consumer

- A copy of the report, and
- A description in writing of the rights of the consumer, as prescribed by the Federal Trade Commission (FTC) in FCRA, section 609(c)(1).

At the time a financial institution takes adverse action in an employment situation, the consumer must also be provided with an adverse action notice, as required by FCRA, section 615, and described later in this module.

### Prescreened Consumer Reports and Opt-Out Notice (FCRA, Sections 604(c) and 615(d); and FTC Regulations, Parts 642 and 698)

FCRA, section 604(c)(1)(B), allows persons, including financial institutions, to obtain and use consumer reports on any consumer in connection with any credit or insurance transaction that is not initiated by the consumer, for the purpose of making firm offers of credit or insurance. This process, known as *prescreening*, occurs when a financial institution obtains, from a consumer reporting agency, a list of consumers who meet certain predetermined creditworthiness criteria and who have not elected to be

excluded from such lists. These lists may contain only the following information:

- The name and address of a consumer
- An identifier that is not unique to the consumer and that is used by the person solely for the purpose of verifying the identity of the consumer
- Other information pertaining to a consumer that does not identify the relationship or experience of the consumer with respect to a particular creditor or other entity

Each name on the list is considered an individual consumer report. In order to obtain and use these lists, the financial institution must make a “firm offer of credit or insurance,” as defined in FCRA, section 603(l), to each person on the list. The institution is not required to grant credit or insurance if the consumer is found to be not creditworthy or insurable or cannot furnish required collateral, provided that the underwriting criteria are determined in advance.

*Example 1.* Assume that a home mortgage lender obtains from a consumer reporting agency a list of everyone in county X who has a current home mortgage loan and a credit score of 700. The lender will use this list to market a second-lien home equity loan product. Besides the criteria used to create the prescreened list for this product, the lender’s criteria include a total debt-to-income ratio (DTI) of 50 percent or less. Some of these other criteria can be screened by the consumer reporting agency, but others, such as the DTI, must be determined from an application or other sources when consumers respond to the offer. If a consumer who responds to the offer has a DTI of 60 percent, the lender does not have to grant the loan.

In addition, the financial institution is allowed to obtain a full consumer report on anyone responding to the offer in order to verify that the consumer continues to meet the creditworthiness criteria. If the consumer no longer meets those criteria, the institution does not have to grant the loan.

*Example 2.* On January 1, a credit card lender obtains from a consumer reporting agency a list of consumers in county Y who have credit scores of 720 and no previous bankruptcy records. On January 2, the lender mails solicitations offering a preapproved credit card to everyone on the list. On January 31, a consumer responds to the offer and the lender obtains and reviews a full consumer report, which shows that a bankruptcy record was added on January 15. Since this

consumer no longer meets the lender's predetermined criteria, the lender is not required to issue the credit card.

These basic requirements seek to ensure that financial institutions that obtain prescreened lists follow through with an offer of credit or insurance. An institution must maintain a list of the criteria used for the product (including the criteria used to generate the prescreened list and any other criteria, such as collateral requirements) on file for three years, beginning on the date that the offer was made to the consumer.

## Technical Notice and Opt-Out Requirements

FCRA, section 615(d), sets forth consumer protections and technical notice requirements concerning prescreened offers of credit or insurance. The FCRA requires consumer reporting agencies that operate nationwide to jointly operate an "opt-out" system whereby consumers can elect to be excluded from prescreened lists by calling a toll-free number.

When a financial institution obtains and uses such lists, it must provide consumers with a "prescreen opt-out notice" along with a written offer of credit or insurance. The notice alerts consumers that they are receiving the offer because they meet certain creditworthiness criteria. The notice must also provide the toll-free telephone number operated by the nationwide consumer reporting agencies for consumers to call to opt out of prescreened lists.

The FCRA sets forth the basic requirement concerning the provision of notices to consumers at the time prescreened offers are made. The FTC's implementing regulation, which spells out the technical requirements of the notice, are at 16 CFR 642 and 698. This regulation—which is applicable to anyone, including banks, credit unions, and thrifts, that obtains and uses prescreened consumer reports—became effective on August 1, 2005; however, the requirement to provide a notice containing the toll-free opt-out telephone number has existed under the FCRA for many years.

### Requirements Beginning August 1, 2005

The FTC regulations—16 CFR 642 and 698—require that a "short" notice and a "long" notice of the "prescreen opt-out" information be given with each written solicitation made to consumers on the basis of prescreened consumer reports. These regulations, which were published on January 31, 2005, at 70 FR 5022, also contain specific requirements concerning the content and appearance of these notices. The requirements are listed below.

The short notice must be a clear and conspicuous, simple, and easy-to-understand statement, as follows:

- **Content.** The short notice must state that the consumer has the right to opt out of receiving prescreened solicitations, must provide the toll-free number, must direct consumers to the existence and location of the long notice, and must state the title of the long notice. It *may not* contain any other information.
- **Form.** The short notice must be in a type size larger than the principal text on the same page, but it may not be smaller than 12 point type. If the notice is provided by electronic means, it must be larger than the type size of the principal text on the same page.
- **Location.** The short notice must be on the front side of the first page of the principal promotional document in the solicitation or, if provided electronically, on the same page and in close proximity to the principal marketing message. The statement must be located so that it is distinct from other information, such as inside a border, and must be in a distinct type style, such as bolded, italicized, underlined, and/or in a color that contrasts with the principal text on the page, if the solicitation is provided in more than one color.

The long notice must also be a clear and conspicuous, simple, and easy-to-understand statement, as follows:

- **Content.** The long notice must state the information required by FCRA, section 615(d), and may not include any other information that interferes with, detracts from, contradicts, or otherwise undermines the purpose of the notice.
- **Form.** The long notice must appear in the solicitation and be in a type size that is no smaller than the type size of the principal text on the same page; for solicitations provided other than by electronic means, the type size may not be smaller than 8-point. The notice must begin with a heading, in capital letters and underlined, identifying the long notice as the "PRESCREEN & OPT OUT NOTICE." Also, the notice must be in a type style that is distinct from the principal type style used on the same page, such as bolded, italicized, underlined, and/or in a color that contrasts with the principal text, if the solicitation is in more than one color. Further, the notice must be set apart from other text on the page, such as by including a blank line above and below the statement, and by indenting both the left and right margins from other text on the page.

Model prescreen opt-out notices developed by the FTC, along with complete sample solicitations

showing context, appear in appendix A to 16 CFR 698. The model notice text is shown below.

### Sample Short Notice

*You can choose to stop receiving "prescreened" offers of [credit or insurance] from this and other companies by calling toll-free [toll-free number]. See PRESCREEN & OPT-OUT NOTICE on other side [or other location] for more information about prescreened offers.*

### Sample Long Notice

*PRESCREEN & OPT-OUT NOTICE: This "prescreened" offer of [credit or insurance] is based on information in your credit report indicating that you meet certain criteria. This offer is not guaranteed if you do not meet our criteria [including providing acceptable property as collateral]. If you do not want to receive prescreened offers of [credit or insurance] from this and other companies, call the consumer reporting agencies [or name of consumer reporting agency] toll-free, [toll-free number]; or write: [consumer reporting agency name and mailing address].*

## Truncation of Credit and Debit Card Account Numbers (FCRA, Section 605(g))

FCRA, section 605(g), provides that persons, including financial institutions, that accept debit and credit cards for the transaction of business are prohibited from issuing electronically generated receipts that contain more than the last five digits of the card number, or the card expiration date, at the point of sale or transaction. This requirement applies only to electronically developed receipts and does not apply to handwritten receipts or those developed with an imprint of the card.

For automatic teller machines (ATMs) and point-of-sale (POS) terminals or other machines that were put into operation before January 1, 2005, this requirement is effective on December 4, 2006. For those that were put into operation on or after January 1, 2005, the effective date is the date of installation.

## Disclosure of Credit Scores by Certain Mortgage Lenders (FCRA, Section 609(g))

FCRA, section 609(g), requires financial institutions that make or arrange mortgage loans using credit scores to provide the score, with accompanying information, to applicants.

## Credit Score

For purposes of this section, *credit score* is defined as a numerical value or a categorization derived from a statistical tool or modeling system used by a person that makes or arranges a loan to predict the likelihood of certain credit behaviors, including default (the numerical value or the categorization derived from such analysis may also be referred to as a "risk predictor" or "risk score"). A credit score does not include

- Any mortgage score or rating by an automated underwriting system that considers one or more factors in addition to credit information, such as the loan-to-value ratio, the amount of down payment, or the financial assets of a consumer, or
- Any other elements of the underwriting process or underwriting decision.

## Covered Transactions

The disclosure requirement applies to both closed-end and open-end loans that are for consumer purposes and are secured by one- to four-family residential real properties, including purchase and refinance transactions. The requirement does not apply in circumstances that do not involve a consumer purpose, such as when a borrower obtains a loan secured by his or her residence to finance his or her small business.

## Specific Required Notice

Financial institutions that are engaged in covered transactions and that use credit scores must provide a disclosure containing the specific language shown below, which is contained in FCRA, section 609(g)(1)(D):

### *Notice to the Home Loan Applicant*

*In connection with your application for a home loan, the lender must disclose to you the score that a consumer reporting agency distributed to users and the lender used in connection with your home loan, and the key factors affecting your credit scores.*

*The credit score is a computer generated summary calculated at the time of the request and based on information that a consumer reporting agency or lender has on file. The scores are based on data about your credit history and payment patterns. Credit scores are important because they are used to assist the lender in determining whether you will obtain a loan. They may also be used to determine what interest rate you may be offered on the mortgage. Credit scores can change over time, depending on your conduct, how your credit history and payment patterns change, and how credit scoring technologies change.*

*Because the score is based on information in your credit history, it is very important that you review the credit-related information that is being furnished to make sure it is accurate. Credit records may vary from one company to another.*

*If you have questions about your credit score or the credit information that is furnished to you, contact the consumer reporting agency at the address and telephone number provided with this notice, or contact the lender, if the lender developed or generated the credit score. The consumer reporting agency plays no part in the decision to take any action on the loan application and is unable to provide you with specific reasons for the decision on a loan application.*

*If you have questions concerning the terms of the loan, contact the lender.*

The notice must include the name, address, and telephone number of each consumer reporting agency that provided a credit score that was used.

## Credit Score and Key Factors Disclosed

In addition to providing the notice to home loan applicants, financial institutions must disclose the credit score, the range of possible scores, the date on which the score was created, and the “key factors” used in calculating the score. *Key factors* are all relevant elements or reasons adversely affecting the credit score for the particular individual, listed in the order of their importance based on their effect on the credit score. The total number of factors to be disclosed must not exceed four. However, if one of the key factors is the number of inquiries into a consumer’s credit information, then the total number of factors must not exceed five. These key factors come from information supplied by the consumer reporting agencies with any consumer report that was furnished containing a credit score. (FCRA, section 605(d)(2))

This disclosure requirement applies to any application for a covered transaction, regardless of the final action on the application taken by the lender. The FCRA requires a financial institution to disclose all of the credit scores that were used in these transactions. For example, if two applicants jointly apply for a mortgage loan to purchase a single-family residence and the lender uses the credit scores of both, then both scores need to be disclosed. The statute specifically does not require that more than one disclosure be provided per loan; therefore, if multiple scores are used, all of them can be included in one disclosure containing the Notice to the Home Loan Applicant.

If a financial institution uses a credit score that was not obtained directly from a consumer reporting agency but may contain some information from a consumer reporting agency, this disclosure

requirement can be satisfied by providing a score and associated key factor information that were supplied by the consumer reporting agency. For example, certain automated underwriting systems generate scores used in credit decisions. These systems are often populated by data obtained from consumer reporting agencies. If a financial institution uses such an automated system, the disclosure requirement can be satisfied by providing the applicants with a score and list of key factors supplied by a consumer reporting agency based on the data, including the credit score(s), that were imported into the automated system. Doing so will provide applicants with information about their credit history and its role in the credit decision, in the spirit of this section of the statute.

## Timing

The statute requires that the disclosure be provided as soon as is reasonably practicable after the credit score is used.

## Adverse Action Disclosures (FCRA, Sections 615(a) and (b))

The FCRA requires certain disclosures when adverse actions are taken with respect to consumers on the basis of information received from third parties. Specific disclosures are required depending on whether the source of the information is a consumer reporting agency, a third party other than a consumer reporting agency, or an affiliate. The disclosure requirements are discussed separately below.

## Information Obtained from a Consumer Reporting Agency

Section 615(a) provides that when adverse action is taken with respect to any consumer that is based in whole or in part on any information contained in a consumer report, the financial institution must do all of the following:

- Provide oral, written, or electronic notice of the adverse action to the consumer
- Provide to the consumer, orally, in writing, or electronically,
  - The name, address, and telephone number of the consumer reporting agency from which it received the information (including a toll-free telephone number established by the agency, if the agency maintains files on a nationwide basis)
  - A statement that the consumer reporting agency did not make the decision to take the adverse action and is unable to give the

consumer the specific reasons for the adverse action

- Provide to the consumer an oral, written, or electronic notice of (1) the consumer's right to obtain a free copy of the consumer report from the consumer reporting agency, within sixty days of receiving notice of the adverse action, and (2) the consumer's right to dispute the accuracy or completeness of any information in the consumer report with the consumer reporting agency

### Information Obtained from a Source Other Than a Consumer Reporting Agency

Section 615(b)(1) provides that if credit for personal, family, or household purposes involving a consumer is denied or if the charge for such credit is increased, partially or wholly on the basis of information that was obtained from a person other than a consumer reporting agency and that bears on the consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living, the financial institution,

- At the time the adverse action is communicated to the consumer, must clearly and accurately disclose the consumer's right to file a written request for the reasons for the adverse action, and
- If it receives such a request within sixty days after the consumer learns of the adverse action, must disclose, within a reasonable period of time, the nature of the adverse information. The information should be sufficiently detailed to enable the consumer to evaluate its accuracy. The source of the information need not be, but may be, disclosed. In some instances, it may be impossible to identify the nature of certain information without also revealing the source.

### Information Obtained from an Affiliate

Section 615(b)(2) provides that if a person, including a financial institution, takes an adverse action involving credit (in connection with a transaction initiated by a consumer), insurance, or employment in whole or in part on the basis of information provided by an affiliate, it must notify the consumer that the information

- Is furnished to the person taking the action by a person related by common ownership, or affiliated by common corporate control, to the person taking the action;
- Bears upon the consumer's creditworthiness, credit standing, credit capacity, character, gen-

eral reputation, personal characteristics, or mode of living;

- Is not information solely involving transactions or experiences between the consumer and the person furnishing the information; and
- Is not information in a consumer report.

The notification must inform the consumer of the adverse action and that the consumer may obtain a disclosure of the nature of the information relied on by making a written request within sixty days of transmittal of the adverse action notice. If the consumer makes such a request, the user must disclose the nature of the information received from the affiliate not later than thirty days after receiving the request.

### Debt Collector Communications concerning Identity Theft (FCRA, Section 615(g))

Section 615(g) sets forth specific requirements for financial institutions that act as debt collectors, that is, financial institutions that collect debts on behalf of a third party that is a creditor or other user of a consumer report. The requirements do not apply when a financial institution is collecting its own loans. When a financial institution is notified that any information relating to a debt that it is attempting to collect may be fraudulent or may be the result of identity theft, the institution must notify the third party of this fact. In addition, if the consumer to whom the debt purportedly relates requests information about the transaction, the financial institution must provide all of the information the consumer would otherwise be entitled to if the consumer wished to dispute the debt under other provisions of law applicable to the financial institution.

### Risk-Based Pricing Notice (FCRA, Section 615(h))

Section 615(h) requires users of consumer reports that grant credit on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers who get credit from or through that person to provide a notice to those consumers who did not receive the most favorable terms. Implementing regulations for this section are currently (as of August 2006) under development jointly by the Federal Reserve Board and the Federal Trade Commission. Financial institutions do not have to provide this notice until final regulations are implemented and effective. This section of the examination procedures will be written upon publication of final rules.



# Fair Credit Reporting—Module 3

## Examination Procedures

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### Use of Consumer Reports for Employment Purposes (FCRA, Section 604(b))

1. Determine whether the financial institution obtains consumer reports on current or prospective employees.
2. Assess the financial institution's policies and procedures to determine if appropriate disclosures are provided to current and prospective employees when consumer reports are obtained for employment purposes, including in situations in which adverse actions are taken on the basis of consumer report information.
3. If procedural weaknesses or other risks requiring further investigation are noted, review a sample of the disclosures to determine if they are accurate and in compliance with the technical FCRA requirements.

### Prescreened Consumer Reports and Opt-Out Notice (FCRA, Sections 604(c) and 615(d); and FTC Regulations, Parts 642 and 698)

1. Determine whether the financial institution obtained and used prescreened consumer reports in connection with offers of credit and/or insurance.
2. Evaluate the institution's policies and procedures to determine if a list of the criteria used for prescreened offers, including all post-application criteria, is maintained in the institution's files and the criteria are applied consistently when consumers respond to the offers.
3. Determine whether written solicitations contain the required disclosures of consumers' right to opt out of prescreened solicitations and comply with all requirements applicable at the time of the offer.
4. If procedural weaknesses or other risks requiring further investigation are noted, obtain and review a sample of approved and denied responses to the offers to ensure that criteria were appropriately applied.

### Truncation of Credit and Debit Card Account Numbers (FCRA, Section 605(g))

1. Determine whether the financial institution's

policies and procedures ensure that electronically generated receipts from automated teller machines and point-of-sale terminals or other machines do not contain more than the last five digits of the card number and do not contain the expiration date.

2. For ATMs and POS terminals or other machines that were put into operation before January 1, 2005, determine if the institution has brought the terminals into compliance or has begun a plan to ensure that these terminals comply by the mandatory compliance date of December 4, 2006.
3. If procedural weaknesses or other risks requiring further investigation are noted, review samples of actual receipts to ensure compliance.

### Disclosure of Credit Scores by Certain Mortgage Lenders (FCRA, Section 609(g))

1. Determine whether the financial institution uses credit scores in connection with applications for closed-end or open-end loans secured by one-to four-family residential real property.
2. Evaluate the institution's policies and procedures to determine whether accurate disclosures are provided to applicants as soon as is reasonably practicable after using credit scores.
3. If procedural weaknesses or other risks requiring further investigation are noted, review a sample of disclosures given to home loan applicants to determine technical compliance with the requirements.

### Adverse Action Disclosures (FCRA, Sections 615(a) and (b))

1. Determine whether the financial institution's policies and procedures adequately ensure that appropriate disclosures are provided when adverse action is taken against consumers on the basis of information received from consumer reporting agencies, other third parties, and/or affiliates.
2. Review the financial institution's policies and procedures for responding to requests for information in response to these adverse action notices.
3. If procedural weaknesses or other risks requiring further investigation are noted, review a



sample of adverse action notices to determine if they are accurate and in technical compliance.

### **Debt Collector Communications concerning Identity Theft (FCRA, Section 615(g))**

1. Determine whether the financial institution collects debts for third parties.
2. Determine whether the financial institution has policies and procedures to ensure that the third parties are notified if the financial institution obtains any information that may indicate that the debt in question is the result of fraud or identity theft.
3. Determine if the institution has effective policies and procedures for providing information to consumers to whom the fraudulent debts relate.
4. If procedural weaknesses or other risks requiring further investigation are noted, review a sample of instances in which consumers have alleged identity theft and requested information

related to transactions to determine if all of the appropriate information was provided to the consumers.

### **Risk-Based Pricing Notice (FCRA, Section 615(h))**

Section 615(h) requires users of consumer reports that grant credit on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers who get credit from or through that person to provide a notice to those consumers who did not receive the most favorable terms. Implementing regulations for this section are currently (as of August 2006) under development jointly by the Federal Reserve Board and the Federal Trade Commission. Financial institutions do not have to provide this notice until final regulations are implemented and effective. This section of the examination procedures will be written upon publication of final rules.

# Fair Credit Reporting

## Examination Module 4: Duties of Users of Credit Reports and Furnishers of Consumer Information

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### Overview

The Fair Credit Reporting Act (FCRA) sets forth many responsibilities for financial institutions that use credit reports and furnish information to consumer reporting agencies. Those responsibilities generally concern ensuring the accuracy of the data that are placed in the consumer reporting system. This examination module addresses the various areas associated with users of credit reports and furnishers of information; it does not apply to financial institutions that do not furnish information to consumer reporting agencies.

### Duties of Users of Credit Reports Regarding Address Discrepancies (Regulation V, Section 222.82)

Section 605(h)(1) of the Fair Credit Reporting Act requires that, when providing a consumer report to a person that requests the report (a user), a nationwide consumer reporting agency (NCRA) must provide a notice of address discrepancy to the user if the address provided by the user in its request “substantially differs” from the address the NCRA has in the consumer’s file. Section 605(h)(2) requires the federal banking agencies and the National Credit Union Administration (collectively, the Agencies) and the Federal Trade Commission to prescribe regulations providing guidance regarding reasonable policies and procedures that a user of a consumer report should employ when such user has received a notice of address discrepancy. On November 9, 2007, the agencies published final rules in the Federal Register (72 FR 63718) implementing this section.

### Definitions

1. *Nationwide consumer reporting agency.* Section 603(p) defines an NCRA as one that compiles and maintains files on consumers on a nationwide basis and regularly engages in the practice of assembling or evaluating and maintaining the following two pieces of information about consumers residing nationwide for the purpose of furnishing consumer reports to third parties bearing on a consumer’s credit worthiness, credit standing, or credit capacity:
  - a. Public record information, and
  - b. Credit account information from persons who furnish that information regularly and in the ordinary course of business.

2. *Notice of address discrepancy (12 CFR 222.82(b)).* A “notice of address discrepancy” is a notice sent to a user by an NCRA (section 603(p)) that informs the user of a substantial difference between the address for the consumer that the user provided to request the consumer report and the address(es) in the NCRA’s file for the consumer.

### Requirement to Form a Reasonable Belief (12 CFR 222.82(c)).

A user must develop and implement reasonable policies and procedures designed to enable the user to form a reasonable belief that the consumer report relates to the consumer whose report was requested, when the user receives a notice of address discrepancy in connection with a new or existing account.

The rules provide the following examples of reasonable policies and procedures for forming a reasonable belief that a consumer report relates to the consumer whose report was requested:

1. Comparing information in the consumer report with information the user
  - a. Has obtained and used to verify the consumer’s identity as required by the Customer Identification Program rules (31 CFR 103.121);
  - b. Maintains in its records; or
  - c. Obtains from a third party.
2. Verifying the information in the consumer report with the consumer.

### Requirement to Furnish a Consumer’s Address to an NCRA (12 CFR 222.82(d)).

A user must develop and implement reasonable policies and procedures for furnishing to the NCRA an address for the consumer that the user has reasonably confirmed is accurate when the user

1. Can form a reasonable belief that the report relates to the consumer whose report was requested;
2. Establishes a continuing relationship with the consumer (that is, in connection with a new account); and
3. Regularly, and in the ordinary course of business, furnishes information to the NCRA that provided the notice of address discrepancy.

A user's policies and procedures for furnishing a consumer's address to an NCRA must require the user to furnish the confirmed address as part of the information it regularly furnishes to the NCRA during the reporting period when it establishes a continuing relationship with the consumer.

The rules also provide the following examples of how a user may reasonably confirm an address is accurate:

1. Verifying the address with the consumer whose report was requested
2. Reviewing its own records
3. Verifying the address through third-party sources or
4. Using other reasonable means

### **Furnishers of Information—General (FCRA, Section 623)**

The examination procedures for this subsection will be amended upon completion of interagency guidance for institutions regarding the accuracy and integrity of information furnished to consumer reporting agencies (the guidance is required by the Fair and Accurate Credit Transactions Act of 2003 (FACT Act)). An interagency working group will develop and publish the guidance for comment and will finalize it at a later date. The agencies will also, at a later date, write regulations regarding when furnishers must handle direct disputes from consumers.

In the interim, institutions that furnish information to consumer reporting agencies must comply with the existing FCRA requirements, which generally require accurate reporting and prompt investigation and resolution of disputes over accuracy. The examination procedures presented here are based largely on the procedures last approved by the FFIEC Task Force on Consumer Compliance in March 2000, but they have been revised to include new requirements under the 2003 amendments to the FCRA that do not require implementing regulations.

#### **Duties of Furnishers to Provide Accurate Information**

Section 623(a) states that a person, including a financial institution, may, but need not, specify an address to which consumers may send notices concerning inaccurate information. If the financial institution specifies such an address, then it may not furnish information relating to a consumer to any consumer reporting agency if (1) the institution has been notified by the consumer, at the specified address, that the information is inaccurate and

(2) the information is in fact inaccurate. If the financial institution does not specify an address, then it may not furnish any information relating to a consumer to any consumer reporting agency if it knows or has reasonable cause to believe that the information is inaccurate.

When a financial institution that (regularly and in the ordinary course of business) furnishes information to one or more consumer reporting agencies about its transactions or experiences with any consumer determines that any such information is not complete or accurate, the institution must promptly notify the consumer reporting agency of that determination. Corrections to that information or any additional information necessary to make the information complete and accurate must be provided to the consumer reporting agency. Further, any information that remains incomplete or inaccurate must not thereafter be furnished to the consumer reporting agency.

If the completeness or accuracy of any information furnished by a financial institution to a consumer reporting agency is disputed by a consumer, that financial institution may not furnish the information to any consumer reporting agency without notice that the information is disputed by the consumer.

#### **Voluntary Closures of Accounts**

Section 623(a)(4) requires that any person, including a financial institution, that (regularly and in the ordinary course of business) furnishes information to a consumer reporting agency regarding a consumer who has a credit account with that institution notify the agency of the voluntary closure of the account by the consumer, in information regularly furnished for the period in which the account is closed.

#### **Notice Involving Delinquent Accounts**

Section 623(a)(5) requires that a person, including a financial institution, that furnishes information to a consumer reporting agency about a delinquent account being placed for collection, charged off, or subjected to any similar action, not later than ninety days after furnishing the information to the agency, notify the agency of the month and year of the commencement of the delinquency that immediately preceded the action.

#### **Duties upon Notice of Dispute**

Section 623(b) requires the financial institution to do the following whenever it receives a notice of dispute from a consumer reporting agency regarding the accuracy or completeness of any informa-

tion provided by the institution to the agency pursuant to FCRA, section 611 (Procedure in Case of Disputed Accuracy):

- Conduct an investigation regarding the disputed information
- Review all relevant information provided by the consumer reporting agency along with the notice
- Report the results of the investigation to the consumer reporting agency
- If the disputed information is found to be incomplete or inaccurate, report those results to all nationwide consumer reporting agencies to which the financial institution previously provided the information
- If the disputed information is incomplete, inaccurate, or not verifiable by the financial institution, for purposes of reporting to the consumer reporting agency,
  - Modify the item of information,
  - Delete the item of information, or
  - Permanently block the reporting of that item of information

The investigations, reviews, and reports required to be made must be completed within thirty days. The time period may be extended for fifteen days if a consumer reporting agency receives additional relevant information from the consumer.

### Prevention of Re-Pollution of Consumer Reports (FCRA, Section 623(a)(6))

Section 623(a)(6) has specific requirements for furnishers of information, including financial institutions, to a consumer reporting agency that receives notice from a consumer reporting agency that the information furnished may be fraudulent as a result of identity theft. FCRA, section 605B, requires consumer reporting agencies to notify furnishers of information, including financial institutions, that the information may be fraudulent as a result of identity theft, that an identity theft report has been filed, and that a block has been requested. Section 623(a)(6) requires financial institutions, upon receiving such notice, to establish and follow reasonable procedures to ensure that this information is not re-reported to the consumer reporting agency, thus “re-polluting” the victim’s consumer report.

FCRA, section 615(f), also prohibits a financial institution from selling or transferring debt resulting from an alleged identity theft.

### Negative Information Notice (FCRA, Section 623(a)(7))

Section 623(a)(7) requires financial institutions to provide consumers with a notice either before negative information is provided to a nationwide consumer reporting agency or within thirty days after reporting the negative information.

Financial institutions may provide this disclosure on or with any notice of default, any billing statement, or any other materials provided to the customer, as long as the notice is clear and conspicuous. Institutions may also choose to provide this notice to all customers as an abundance of caution. However, this notice may not be included in the initial disclosures provided under section 127(a) of the Truth in Lending Act.

### Negative Information

For these purposes, *negative information* is any information concerning a customer’s delinquencies, late payments, insolvency, or any form of default.

### Nationwide Consumer Reporting Agency

FCRA, section 603(p), defines a *consumer reporting agency that compiles and maintains files on consumers on a nationwide basis* as one that regularly engages in the practice of assembling or evaluating and maintaining the following two pieces of information about consumers residing nationwide, for the purpose of furnishing consumer reports to third parties bearing on a consumer’s creditworthiness, credit standing, or credit capacity:

- Public record information
- Credit account information from persons who furnish that information regularly and in the ordinary course of business

### Model Notices

As required by the FCRA, the Federal Reserve Board developed the following model notices that financial institutions may use to comply with these requirements. One model notice is to be used when an institution chooses to provide a notice before furnishing negative information. The other is to be used when an institution provides a notice within thirty days after reporting negative information:

- *Notice prior to communicating negative information (model B-1).* “We may report information about your account to credit bureaus. Late

payments, missed payments, or other defaults on your account may be reflected in your credit report.”

- *Notice within thirty days after communicating negative information (model B-2).* “We have told a credit bureau about a late payment, missed payment or other default on your account. This information may be reflected in your credit report.”

Use of the model notices is not required; however, proper use of the model notices provides financial institutions with a safe harbor from liability. Financial institutions may make certain changes to the language or format of the model notices without losing the safe harbor from liability provided by the models, but the changes may not be so extensive as to affect the substance, clarity, or meaningful

sequence of the language in the models. Institutions making such extensive revisions will lose the safe harbor from liability that the model notices provide. Acceptable changes include, for example,

- Rearranging the order of the references to “late payment(s)” or “missed payment(s)”;
- Pluralizing the terms “credit bureau,” “credit report,” and “account”;
- Specifying the particular type of account on which information may be furnished, such as “credit card account”; and
- Rearranging, in model B-1, the phrases “information about your account” and “to credit bureaus” such that it would read “We may report to credit bureaus information about your account.”

# Fair Credit Reporting—Module 4

## Examination Procedures

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1. Determine whether a user of consumer reports has policies and procedures to recognize notices of address discrepancy that it receives from a nationwide consumer reporting agency (NCRA)<sup>16</sup> in connection with consumer reports.
2. Determine whether a user that receives notices of address discrepancy has policies and procedures to form a reasonable belief that the consumer report relates to the consumer whose report was requested (12 CFR 222.82(c)).  
See examples of reasonable policies and procedures “to form a reasonable belief” in 12 CFR 222.82(c)(2).
3. Determine whether a user that receives notices of address discrepancy has policies and procedures in place to furnish to the NCRA an address for the consumer that the user has reasonably confirmed is accurate, if the user
  - a. Can form a reasonable belief that the report relates to the consumer;
  - b. Establishes a continuing relationship with the consumer; and
  - c. Regularly, and in the ordinary course of business, furnishes information to the NCRA (12 CFR 222.82(d)(1)).  
See examples of reasonable confirmation methods in 12 CFR 222.82(d)(2).
4. Determine whether the user’s policies and procedures require it to furnish the confirmed address as part of the information it regularly furnishes to an NCRA during the reporting period when it establishes a relationship with the consumer (12 CFR 222.82(d)(3)).
5. If procedural weaknesses or other risks requiring further information are noted, obtain a sample of consumer reports requested by the user from an NCRA that included notices of address discrepancy and determine
  - a. How the user established a reasonable belief that the consumer reports related to the consumers whose reports were requested; and
  - b. If a consumer relationship was established,
    - i. Whether the institution furnished a consumer’s address that it reasonably confirmed to the NCRA from which it re-

ceived the notice of address discrepancy; and

- ii. Whether it furnished the address in the reporting period during which it established the relationship.

*Conclusion:* On the basis of examination procedures completed, form a conclusion about the ability of the user’s policies and procedures to meet regulatory requirements for the proper handling of address discrepancies reported by an NCRA.

### Furnishers of Information—General (FCRA, Section 623)

1. Determine whether the financial institution provides information to consumer reporting agencies.
2. Review the financial institution’s policies and procedures for ensuring compliance with the FCRA requirements for furnishing information to consumer reporting agencies.
3. If procedural weaknesses or other risks requiring further investigation are noted, such as a high number of complaints from consumers regarding the accuracy of their consumer report information furnished by the financial institution, select a sample of reported items and the corresponding loan or collection file to determine that the institution did the following:
  - a. Did not report information that it knew, or had reasonable cause to believe, was inaccurate (§ 623(a)(1)(A))
  - b. Did not report information to a consumer reporting agency if it was notified by the consumer that the information was inaccurate and the information was, in fact, inaccurate (§ 623(a)(1)(B))
  - c. Provided the consumer reporting agency with corrections or additional information to make the information complete and accurate, and thereafter did not send the consumer reporting agency the inaccurate or incomplete information (§ 623(a)(2))
  - d. Furnished a notice to a consumer reporting agency of a dispute in situations in which a consumer disputed the completeness or accuracy of any information the institution furnished, and the institution continued furnishing the information to a consumer reporting agency (§ 623(a)(3))
  - e. Notified the consumer reporting agency of a

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<sup>16</sup> An NCRA compiles and maintains files on consumers on a nationwide basis. As of the effective date of the rule (January 1, 2008), there were three such consumer reporting agencies: Experian, Equifax, and TransUnion (section 603(p) of FCRA (15 USC 1681a)).

voluntary account-closing by the consumer, and did so as part of the information regularly furnished for the period in which the account was closed (§ 623(a)(4))

- f. Notified the consumer reporting agency of the month and year of commencement of a delinquency that immediately preceded the action of placing the delinquent account for collection, charging it off, or similar action. The notification to the agency must be made within ninety days of furnishing information to the agency about a delinquent account being placed for collection, charged off, or subjected to any similar action (§ 623(a)(5))
4. If weaknesses within the financial institution's procedures for investigating errors are revealed, review a sample of notices of disputes received from a consumer reporting agency and determine whether the institution did the following:
  - a. Conducted an investigation with respect to the disputed information (§ 623(b)(1)(A))
  - b. Reviewed all relevant information provided by the consumer reporting agency (§ 623(b)(1)(B))
  - c. Reported the results of the investigation to the consumer reporting agency (§ 623(b)(1)(C))
  - d. Reported the results of the investigation to all other nationwide consumer reporting agencies to which the information was furnished, if the investigation found that the reported information was inaccurate or incomplete (§ 623(b)(1)(D))
  - e. Modified, deleted, or blocked the reporting of information that could not be verified

### **Prevention of Re-Pollution of Consumer Reports (FCRA, Section 623(a)(6))**

1. If the financial institution provides information to

a consumer reporting agency, review the institution's policies and procedures for ensuring that items of information blocked because of an alleged identity theft are not re-reported to the consumer reporting agency.

2. If weaknesses are noted within the financial institution's policies and procedures, review a sample of notices from a consumer reporting agency of allegedly fraudulent information due to identity theft furnished by the financial institution, to determine whether the institution does not re-report the item to a consumer reporting agency.
3. If procedural weaknesses or other risks requiring further investigation are noted, verify that the financial institution has not sold or transferred a debt that resulted from an alleged identity theft.

### **Negative Information Notice (FCRA, Section 623(a)(7))**

1. If the financial institution provides negative information to a nationwide consumer reporting agency, verify that the institution's policies and procedures ensure that the appropriate notices are provided to customers.
2. If procedural weaknesses or other risks requiring further investigation are noted, review a sample of notices provided to consumers to determine compliance with the technical content and timing requirements.

# Fair Credit Reporting

## Examination Module 5: Consumer Alerts and Identity Theft Protections

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### Overview

The Fair Credit Reporting Act (FCRA) contains several provisions for both consumer reporting agencies and users of consumer reports, including financial institutions, that are designed to help combat identity theft. This module applies to financial institutions that are not consumer reporting agencies but are users of consumer reports. In addition, this module applies to debit and credit card issuers.

There are two primary requirements for users of consumer reports: (1) a user of a consumer report that contains a fraud or active duty alert must take steps to verify the identity of the individual to whom the consumer report relates and (2) a financial institution must disclose certain information when consumers allege that they are the victim of identity theft.

The primary responsibility for card issuers is to assess the validity of address changes before issuing additional or replacement cards.

### Fraud and Active Duty Alerts (FCRA, Section 605A(h))

#### Initial Fraud and Active Duty Alerts

A consumer who suspects that he or she may be the victim of fraud, including identity theft, may ask nationwide consumer reporting agencies to place initial fraud alerts in his or her consumer reports. These alerts must remain in the consumer's report for no less than ninety days. In addition, members of the armed services who are called to active duty may request that active duty alerts be placed in their consumer reports. Active duty alerts must remain in these service members' files for no less than twelve months.

Section 605A(h)(1)(B) requires users of consumer reports, including financial institutions, to verify a consumer's identity if a consumer report includes a fraud or active duty alert. Unless the financial institution uses reasonable policies and procedures to form a reasonable belief that it knows the identity of the person making the request, the financial institution may not

- Establish a new credit plan or extension of credit (other than under an open-end credit plan) in the name of the consumer,
- Issue an additional card on an existing account, or
- Increase a credit limit.

### Extended Alerts

Consumers who allege that they are the victim of identity theft may also place an extended alert, which lasts seven years, on their consumer report. Extended alerts require consumers to submit identity theft reports and appropriate proof of identity to the nationwide consumer reporting agencies.

Section 605A(h)(2)(B) requires a financial institution that obtains a consumer report that contains an extended alert to contact the consumer in person, or by the method listed by the consumer in the alert, prior to taking any of the three actions listed above.

### Information Available to Victims (FCRA, Section 609(e))

Section 609(e) requires financial institutions to provide records of fraudulent transactions to victims of identity theft within thirty days after receiving a request for the records. These records include the application and business transaction records under the control of the financial institution, whether maintained by the institution or another person on behalf of the institution (such as a service provider). This information should be provided to one of the following:

- The victim
- Any federal, state, or local government law enforcement agency or officer specified by the victim in the request
- Any law enforcement agency investigating the identity theft that was authorized by the victim to take receipt of these records

The request for the records must be made by the victim in writing and must be sent to the financial institution to the address specified by the institution for this purpose. The financial institution may ask the victim to provide information, if known, regarding the date of the transaction or application and any other identifying information, such as an account or transaction number.

Unless the financial institution, at its discretion, otherwise has a high degree of confidence that it knows the identity of the victim making the request for information, before disclosing any information to the victim it must take prudent steps to positively identify the person requesting the information. Proof of identity can include any of the following:



- A government-issued identification card
- Personally identifying information of the same type that was provided to the financial institution by the unauthorized person
- Personally identifying information that the financial institution typically requests from new applicants or for new transactions

At the election of the financial institution, the victim must also provide the institution with proof of an identity theft complaint, which may consist of a copy of a police report evidencing the claim of identity theft and a properly completed affidavit. The affidavit may be either the standardized affidavit form prepared by the Federal Trade Commission (published in April 2005 in the *Federal Register* at 70 FR 21792) or an “affidavit of fact” that is acceptable to the financial institution for this purpose.

When these conditions are met, the financial institution must provide the information at no charge to the victim. However, the institution is not required to provide any information if, acting in good faith, it determines that

- Section 609(e) does not require disclosure of the information;
- It does not have a high degree of confidence in knowing the true identity of the requestor, based on the identification and/or proof provided;
- The request for information is based on a misrepresentation of fact by the requestor; or
- The information requested is Internet navigational data or similar information about a person’s visit to a web site or online service.

## Duties of Card Issuers Regarding Changes of Address (FCRA, Section 615(e)(1)(c) and Regulation V, Section 222.91)

### Background

Section 615(e)(1)(C) of the Fair Credit Reporting Act requires the federal banking agencies (agencies) and the Federal Trade Commission to prescribe regulations for debit and credit card issuers regarding the assessment of the validity of address changes for existing accounts. The regulations require card issuers to have procedures to assess the validity of an address change if the card issuer receives a notice of change of address for an existing account, and within a short period of time (during at least the first 30 days) receives a request for an additional or replacement card for the same account. On November 9, 2007, the agencies published final rules in the Federal Register (72 FR

63718) implementing this section.

### Definitions (12 CFR 222.91(b))

The following definitions pertain to the rules governing the duties of card issuers regarding changes of address:

1. A *cardholder* is a consumer who has been issued a credit or debit card.
2. *Clear and conspicuous* means reasonably understandable and designed to call attention to the nature and significance of the information presented.

### Address Validation Requirements (12 CFR 222.91(c))

A card issuer must establish and implement policies and procedures to assess the validity of a change of address if it receives notification of a change of address for a consumer’s debit or credit card account and, within a short period of time afterwards (during at least the first 30 days after it receives such notification), the card issuer receives a request for an additional or replacement card for the same account. In such situations, the card issuer must not issue an additional or replacement card until it assesses the validity of the change of address in accordance with its policies and procedures.

The policies and procedures must provide that the card issuer will

- 1a. Notify the cardholder of the request for an additional or replacement card
  - (i) At the cardholder’s former address, *or*
  - (ii) By any other means of communication that the card issuer and the cardholder have previously agreed to use, *and*
- 1b. Provide to the cardholder a reasonable means of promptly reporting incorrect address changes, *or*
2. Assess the validity of the change of address according to the procedures the card issuer has established as a part of its Identity Theft Prevention Program (12 CFR 222.90).

### Alternative Timing of Address Validation (12 CFR 222.91(d))

A card issuer may satisfy the requirements of these rules prior to receiving any request for an additional or replacement card by validating an address (by one of the methods in 12 CFR 222.91(c)) when it receives an address change notification.

Form of Notice (12 CFR 222.91(e))

Any written or electronic notice that a card issuer provides to satisfy these rules must be clear and

conspicuous and provided separately from its regular correspondence with the cardholder.



# Fair Credit Reporting—Module 5

## Examination Procedures

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### Fraud and Active Duty Alerts (FCRA, Section 605A(h))

1. Determine whether the financial institution has effective policies and procedures in place to verify the identity of consumers in situations in which consumer reports include fraud and/or active duty military alerts.
2. Determine if the financial institution has effective policies and procedures in place to contact consumers in situations in which consumer reports include extended alerts.
3. If procedural weaknesses or other risks requiring further investigation are noted, review a sample of transactions in which consumer reports including these types of alerts were obtained. Verify that the financial institution complied with the identity verification and/or consumer contact requirements.

### Information Available to Victims (FCRA, Section 609(e))

1. Review financial institution policies, procedures, and/or practices to determine whether identities and claims of fraudulent transactions are verified and whether information is properly disclosed to victims of identity theft and/or appropriately authorized law enforcement agents.
2. If procedural weaknesses or other risks requiring further investigation are noted, review a sample of requests of these types to determine whether the financial institution properly verified the requestor's identity prior to disclosing the information.

### Duties of Card Issuers Regarding Changes of Address (FCRA, Section 615(e))

1. Verify that the card issuer has policies and procedures to assess the validity of a change of address if
  - It receives notification of a change of address for a consumer's debit or credit card account; and

- Within a short period of time afterwards (during at least the first 30 days after it receives such notification), the card issuer receives a request for an additional or replacement card for the same account (12 CFR 222.91(c)).
2. Determine whether the policies and procedures prevent the card issuer from issuing additional or replacement cards until it
    - Notifies the cardholder at the cardholder's former address or by any other means previously agreed to and provides the cardholder a reasonable means to promptly report an incorrect address change (12 CFR 222.91(c)(1)(i)-(ii)); or
    - Assesses the validity of the address change in accordance with its procedures established under its Identity Theft Prevention Program (12 CFR 222.91(c)(2)).

In the alternative, a card issuer may validate a change of address request when it is received, using the above methods, *prior* to receiving any request for an additional or replacement card (12 CFR 222.91(d)).

3. Determine whether any written or electronic notice sent to cardholders for purposes of validating a change of address request is clear and conspicuous and is provided separately from any regular correspondence with the cardholder (12 CFR 222.91(e)).
4. If procedural weaknesses or other risks requiring further information are noted, obtain a sample of notifications from cardholders of changes of address and requests for additional or replacement cards to determine whether the card issuer complied with the regulatory requirement to evaluate the validity of the notice of address change before issuing additional or replacement cards.

*Conclusion:* On the basis of examination procedures completed, form a conclusion about whether a card issuer's policies and procedures effectively meet regulatory requirements for evaluating the validity of change of address requests received in connection with credit or debit card accounts.



# Fair Credit Reporting

## Examination Module 6: Requirements for Consumer Reporting Agencies

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Module 6, covering institutions that are considered consumer reporting agencies, will be added later.



# Regulation Z

## Truth in Lending

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### Background

Regulation Z (12 CFR 226) implements the Truth in Lending Act (TILA) (15 USC 1601 et seq.), which was enacted in 1968 as title I of the Consumer Credit Protection Act (Pub. L. 90-321). Since its implementation, the regulation has been amended many times to incorporate changes to the TILA or to address changes in the consumer credit marketplace.

Regulation Z was first revised in 1970 to prohibit creditors from sending consumers unsolicited credit cards. Subsequent revisions to the regulation in the 1970s implemented billing dispute provisions of the Fair Credit Billing Act of 1974 and the Consumer Leasing Act of 1976.

During the 1980s, Regulation Z was changed significantly, first in connection with the Truth in Lending Simplification and Reform Act of 1980. In 1981, all consumer leasing provisions in the regulation were transferred to the Board's Regulation M. During the late 1980s, Regulation Z was amended to implement the rate limitations for home-secured loans set forth in section 1204 of the Competitive Equality Banking Act of 1987 and to require disclosures for adjustable-rate mortgage loans. Other Regulation Z amendments implemented the Fair Credit and Charge Card Disclosure Act of 1988 and the Home Equity Loan Consumer Protection Act of 1988, which required disclosure of key terms at the time of application.

In the 1990s, Regulation Z was amended to implement the Home Ownership and Equity Protection Act of 1994, which imposed new disclosure requirements and substantive limitations on certain higher-cost closed-end mortgage loans and included new disclosure requirements for reverse mortgage transactions. The regulation was also revised to reflect the 1995 Truth in Lending amendments that dealt primarily with tolerances for loans secured by real estate and limitations on lenders' liability for disclosure errors for these types of loans. Regulation Z amendments resulting from the Economic Growth and Regulatory Paperwork Reduction Act of 1996 simplified adjustable-rate mortgage disclosures.

In 2007, Regulation Z was updated to incorporate guidance on the electronic delivery of disclosures consistent with the E-Sign Act.<sup>1</sup>

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1. The Electronic Signatures in Global and National Commerce Act, 15 USC 7001 et seq.

### Applicability

In general, Regulation Z applies to individuals and businesses that offer or extend credit, when all the following conditions are met:

- The credit is offered or extended to consumers
- The offering or extension of credit is done regularly (see the definition of "creditor" in section 226.2(a))
- The credit is subject to a finance charge or is payable by a written agreement in more than four installments
- The credit is primarily for personal, family, or household purposes

The regulation also includes special provisions for credit offered by credit card issuers and specific requirements for persons who are not creditors but who provide applications for home equity loans.

### Organization of Regulation Z

The disclosure rules of Regulation Z differ depending on whether the credit is open-end (credit cards and home equity lines, for example) or closed-end (such as car loans and mortgages). Regulation Z is structured accordingly.

- *Subpart A*—Provides general information that applies to both open-end and closed-end credit transactions, including definitions, explanations of coverage and exemptions, and rules for determining which fees are finance charges
- *Subpart B*—Covers open-end credit, including home equity loans and credit and charge accounts; sets forth rules for providing disclosures, resolving billing errors, calculating annual percentage rates and credit balances, and advertising; describes special rules for credit card transactions (such as prohibitions on the issuance of credit cards and restrictions on the right to offset a cardholder's indebtedness); and provides special rules for home equity lines of credit (such as prohibitions against closing accounts and changing account terms)
- *Subpart C*—Covers closed-end credit, including residential mortgage transactions, demand loans, and installment credit contracts (including direct loans by banks and purchased dealer paper); sets forth rules for disclosures related to regular and variable-rate loans, refinancings and assumptions, and credit balances; also gives rules for calculating annual percentage rates and advertising closed-end credit



- *Subpart D*—For both open- and closed-end credit, sets forth the duty of creditors to retain evidence of compliance with the regulation, clarifies the relationship between the regulation and state law, and requires creditors to set an interest rate cap for variable-rate transactions secured by a consumer's dwelling
- *Subpart E*—Requires additional disclosures for, sets limits on, and prohibits specific acts and practices in connection with certain home mortgage transactions having rates or fees above a certain percentage or amount; also sets forth disclosure requirements for reverse mortgage transactions (both open- and closed-end credit)
- *Appendixes*—Provide model forms and clauses that creditors may use when providing disclosures; detailed rules for calculating APRs for open- and closed-end credit; and instructions for computing the total annual loan cost rate for reverse mortgage transactions, along with tables giving assumed loan periods for those transactions
- *Official staff interpretations*—Published in a commentary normally updated annually, in March; include mandates concerning disclosures not necessarily explicit in the regulation and information on other actions required of creditors (Good faith compliance with the commentary protects creditors from civil liability under the act; it is virtually impossible to comply with the regulation without reference to, and reliance on, the commentary.)

*Note: This chapter does not attempt to discuss all of Regulation Z, but rather highlights areas that have caused the most problems in relation to calculation of the finance charge and the annual percentage rate.*

## General Information (Subpart A)

### Purpose of the TILA and Regulation Z

The Truth in Lending Act is intended to ensure that credit terms are disclosed in a meaningful way so that consumers can compare credit terms more readily and more knowledgeably. Before its enactment, consumers were faced with a vast array of credit terms and rates. It was difficult to compare loans because the terms and rates were seldom presented in the same format. Now, all creditors must use the same credit terminology and expressions of rates. In addition to providing a uniform system for disclosures, the act is designed to

- Protect consumers from inaccurate and unfair credit billing and credit card practices
- Provide consumers with rescission rights
- Provide for rate caps on certain dwelling-secured loans

- Impose limitations on home equity lines of credit and certain closed-end home mortgages

The TILA and Regulation Z do not tell financial institutions how much interest they may charge or whether they must grant a loan to a particular consumer.

### Coverage and Exemptions (§§ 226.1–226.3)

Lenders must carefully consider several factors when deciding whether a loan requires Truth in Lending disclosures or is subject to other Regulation Z requirements. Broad coverage considerations are included in section 226.1(c) of the regulation, and relevant definitions appear in section 226.2. Coverage considerations are addressed in more detail in the commentary to the regulation.

The following transactions are exempt from Regulation Z under section 226.3:

- Credit extended primarily for a business, commercial, or agricultural purpose
- Credit extended to other than a natural person (including credit to government agencies or instrumentalities)
- Credit in excess of \$25,000 not secured by real or personal property used as the consumer's principal dwelling
- Public utility credit
- Credit extended by a broker–dealer registered with the Securities and Exchange Commission or the Commodity Futures Trading Commission involving securities or commodities accounts
- Home fuel budget plans
- Certain student loan programs

Footnote 4 in Regulation Z provides that if a credit card is involved, credit that is generally exempt from the requirements of Regulation Z (for example, credit for a business or agricultural purpose) is still subject to requirements that govern the issuance of credit cards and liability for their unauthorized use. (Credit cards must not be issued on an unsolicited basis, and if a credit card is lost or stolen, the cardholder must not be held liable for more than \$50 for the unauthorized use of the card.)

When determining whether credit is for consumer purposes, the creditor must evaluate the following five factors:

- Information obtained from the consumer describing the purpose of the loan proceeds
  - A statement that the proceeds will be used for a vacation trip, for example, would indicate a consumer purpose.

- If the consumer states that the loan has a mixed purpose (for example, that the proceeds will be used to buy a car that will be used for both personal and business purposes), the lender must look to the primary purpose of the loan to decide whether disclosures are necessary. A statement of purpose by the consumer will help the lender make that decision.
- A checked box indicating that the loan is for a business purpose could, absent any documentation showing the intended use of the proceeds, be insufficient evidence that the loan does not have a consumer purpose.
- The consumer's primary occupation and how it relates to the use of the loan proceeds
  - The higher the correlation between the consumer's occupation and the property purchased from the loan proceeds, the greater the likelihood that the loan has a business purpose. For example, proceeds used to purchase dental supplies for a dentist would indicate a business purpose.
- Personal management of the assets purchased from the loan proceeds
  - The less the borrower is personally involved in the management of the investment or enterprise purchased by the proceeds, the less likely the loan has a business purpose. For example, borrowing money to purchase stock in an automobile company by an individual who does not work for that company would indicate a personal investment and a consumer purpose.
- The size of the transaction
  - The larger the transaction, the more likely the loan has a business purpose. For example, a loan amount of \$5,000,000 for a real estate transaction might indicate a business purpose.
- The amount of income derived from the property acquired by the loan proceeds relative to the borrower's total income
  - The less the income derived from the acquired property, the more likely the loan has a consumer purpose. For example, if the borrower has an annual salary of \$100,000, receiving about \$500 in annual dividends from the acquired property would indicate a consumer purpose.

The lender must evaluate all five factors before concluding that disclosures are not necessary. Normally, evidence suggested by a single factor is, by itself, insufficient to draw a conclusion about whether the transaction is covered by Regulation Z. The diagram "Coverage Considerations under

Regulation Z" may be helpful in making the determination. In any case, the financial institution may choose to furnish disclosures to consumers. Disclosure under such circumstances does not control whether the transaction is covered but can ensure protection to the financial institution and compliance with the law.

## Determination of the Finance Charge and the APR

### Finance Charge (Open-End and Closed-End Credit) (§ 226.4)

The *finance charge* is a measure of the cost of consumer credit represented in dollars and cents. Along with APR disclosures, the disclosure of the finance charge is central to the uniform credit cost disclosure envisioned by the TILA.

Generally, the finance charge includes any charges or fees payable directly or indirectly by the consumer and imposed directly or indirectly by the financial institution either incident to or as a condition of an extension of consumer credit. For example, the finance charge on a loan always includes any interest charges and, often, other charges, such as points, transaction fees, or service fees.

Regulation Z provides examples, applicable to both open-end and closed-end credit transactions, of what must, must not, or need not be included in the disclosed finance charge (section 226.4(b)).

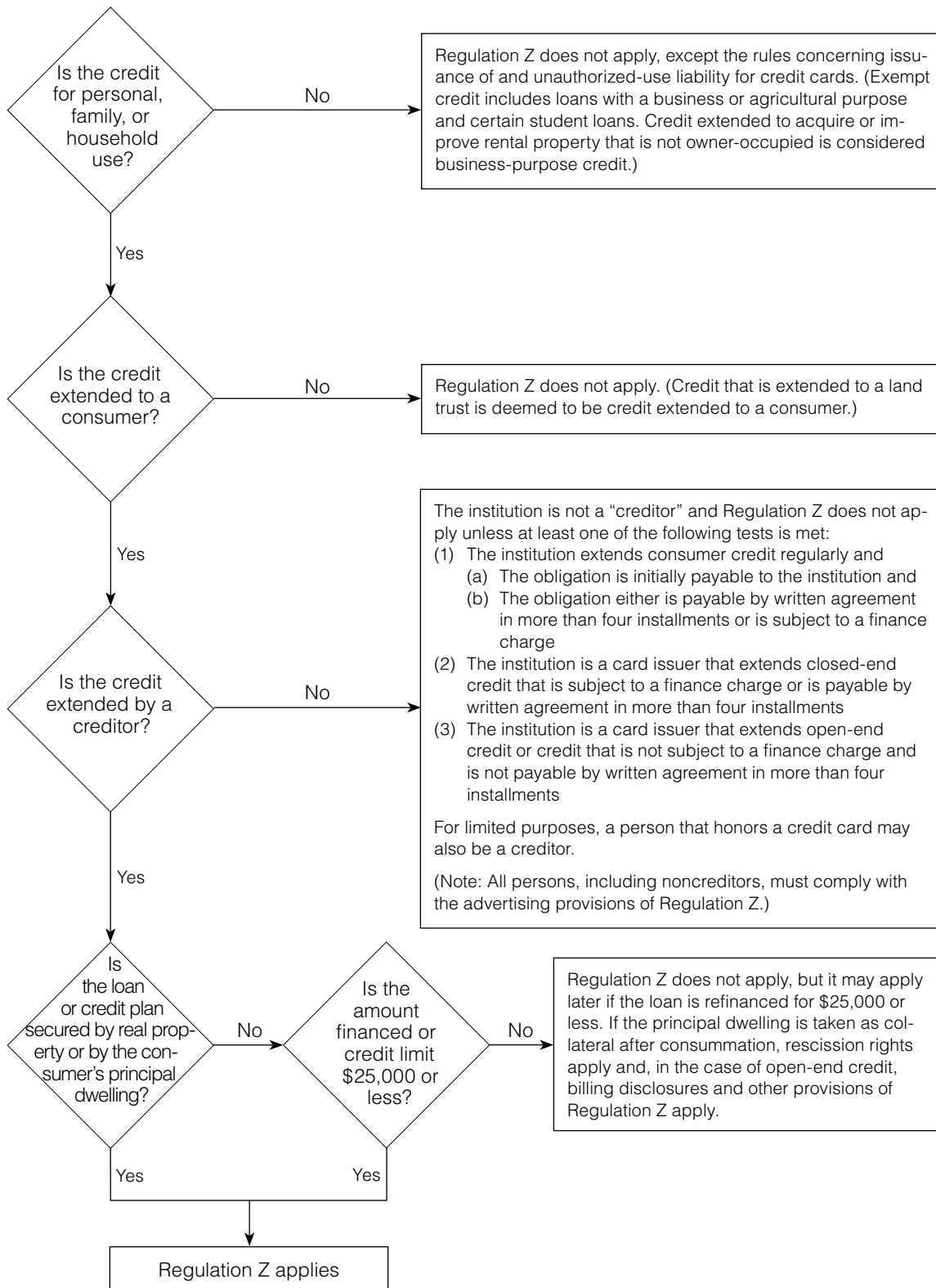
The finance charge does not include any charge of a type payable in a comparable cash transaction, such as taxes, title fees, license fees, or registration fees paid in connection with an automobile purchase.

### *Calculation of the Finance Charge (Closed-End Credit)*

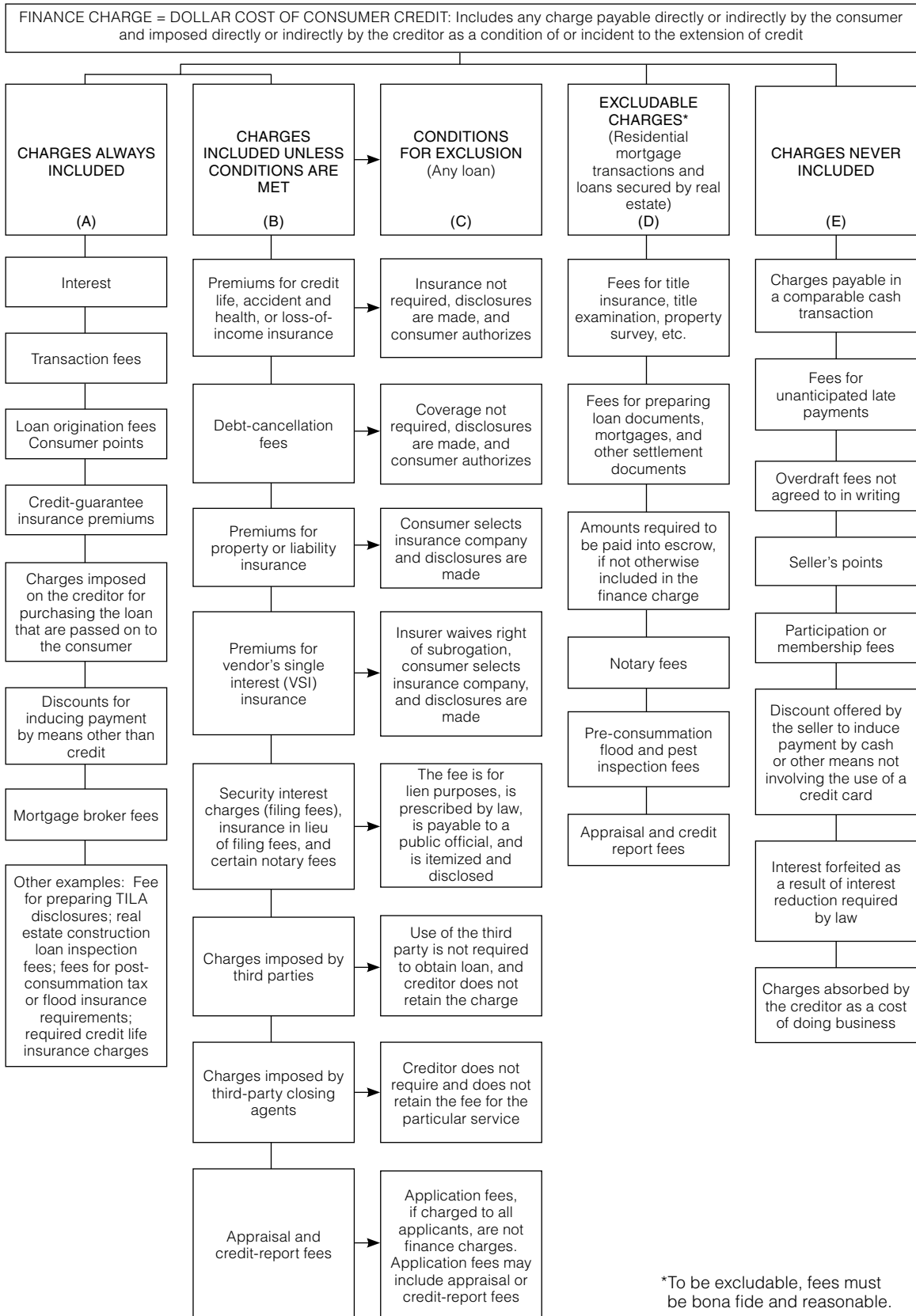
One of the more complex tasks under Regulation Z is determining whether a charge associated with an extension of credit must be included in, or excluded from, the disclosed finance charge. The finance charge initially includes any charge that is, or will be, connected with a specific loan. Charges imposed by third parties are finance charges if the institution requires use of the third party. Charges imposed by settlement or closing agents are finance charges if the institution requires the specific service that gave rise to the charge and the charge is not otherwise excluded.

The "Finance Charges" diagram summarizes included and excluded charges and may be helpful in determining whether a loan-related charge is a finance charge.

## Coverage Considerations under Regulation Z



## Finance Charges



- *Charges always included (col. A)*—Lists charges given in the regulation or commentary as examples of finance charges
- *Charges included unless conditions are met (col. B)*—Lists charges that must be included in the finance charge unless the creditor meets specific disclosure or other conditions to exclude the charges from the finance charge
- *Conditions for exclusion (col. C)*—Notes the conditions that must be met if the charges listed in column B may be excluded from the finance charge. Although most charges in column B may be considered part of the finance charge at the creditor's option, third-party charges and application fees must be excluded from the finance charge if the relevant conditions are met; however, inclusion of appraisal and credit-report charges as part of the application fee is optional.
- *Excludable charges (col. D)*—Identifies fees or charges that may be excluded from the finance charge if they are bona fide and reasonable in amount and the credit transaction is secured by real property or is a residential mortgage transaction. For example, if a consumer loan is secured by a vacant lot or by commercial real estate, any appraisal fees connected with the loan may be excluded from the finance charge.
- *Charges never included (col. E)*—Lists charges given in the regulation as examples of charges that automatically are not finance charges (for example, fees for unanticipated late payments).

#### *Prepaid Finance Charges (§ 226.18(b))*

A *prepaid finance charge* is any finance charge that (1) is paid separately to the financial institution or to a third party, in cash or by check, before or at closing, settlement, or consummation of a transaction or (2) is withheld from the proceeds of the credit at any time. Prepaid finance charges effectively reduce the amount of funds available for the consumer's use, usually before or at the time the transaction is consummated.

Examples of finance charges frequently prepaid by consumers are borrower's points, loan origination fees, real estate construction inspection fees, odd days' interest (interest attributable to part of the first payment period when that period is longer than a regular payment period), mortgage guarantee insurance fees paid to the Federal Housing Administration, private mortgage insurance paid to such companies as the Mortgage Guaranty Insurance Company, and, in non-real-estate transactions, credit-report fees.

#### *Precomputed Finance Charges*

A *precomputed finance charge* includes, for example, interest added to the note amount that is computed by the add-on, discount, or simple interest method. If reflected in the face amount of the debt instrument as part of the consumer's obligation, finance charges that are not viewed as prepaid finance charges are treated as precomputed finance charges that are earned over the life of the loan.

#### *Accuracy Tolerances (Closed-End Credit) (§§ 226.18(d) and 226.23(h))*

The finance charge tolerances for closed-end credit provided by Regulation Z are for legal accuracy and should not be confused with those tolerances provided in the TILA for reimbursement under regulatory agency orders. As with disclosed APRs, if a disclosed finance charge is legally accurate, it is not subject to reimbursement.

Generally, tolerances for finance charge errors in a closed-end transaction are \$5 if the amount financed is \$1,000 or less and \$10 if the amount financed exceeds \$1,000 (see diagrams on following pages). For certain transactions consummated on or after September 30, 1995, the tolerances are different, as noted below:

- Credit secured by real property or a dwelling (closed-end credit only):
  - The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than \$100.
  - Overstatements are not violations.
- Rescission rights after the three-business-day rescission period (closed-end credit only):
  - The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than one-half of 1 percent of the credit extended.
  - The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than 1 percent of the credit extended for the initial and subsequent refinancings of residential mortgage transactions when the new loan is made at a different financial institution. (This category excludes high-cost mortgage loans subject to section 226.32, transactions in which there are new advances, and new consolidations.)
- Rescission rights in foreclosure:
  - The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than \$35.
  - Overstatements are not considered violations.

- The consumer is entitled to rescind if a mortgage broker fee is not included as a finance charge.

Note: Normally, the finance charge tolerance for a rescindable transaction is either 0.5 percent of the credit transaction or, for certain refinancings, 1 percent of the credit transaction. However, in the event of a foreclosure, the consumer may exercise the right of rescission if the disclosed finance charge is understated by more than \$35.

Neither the TILA nor Regulation Z provides any tolerances for finance charge errors in open-end credit disclosures. Open-end credit disclosures must be accurate.

### Annual Percentage Rate (Closed-End Credit) (§ 226.22)

Credit costs may vary depending on the interest rate, the amount of the loan and other charges, the timing and amounts of advances, and the repayment schedule. The APR, which must be disclosed in nearly all consumer credit transactions, is designed to take into account all relevant factors and to provide a uniform measure for comparing the costs of various credit transactions.

The APR is a measure of the total cost of credit, expressed as a nominal yearly rate. It relates the amount and timing of value received by the consumer to the amount and timing of payments made by the consumer. The disclosure of the APR is central to the uniform credit cost disclosure envisioned by the TILA.

The APR for closed-end credit must be disclosed as a single rate only, whether the loan has a single interest rate, a variable interest rate, a discounted variable interest rate, or graduated payments based on separate interest rates (step rates). Also, the APR must appear with the “segregated” disclosures—disclosures grouped together and not containing any information not directly related to the disclosures required under section 226.18.

As the APR is a measure of the total cost of credit, including such costs as transaction charges and premiums for credit-guarantee insurance, it is not an *interest* rate as that term is generally used. APR calculations do not rely on definitions of interest in state law and often include charges, such as a commitment fee paid by the consumer, that are not viewed by some state usury statutes as interest. Conversely, APR calculations might not include charges, such as a credit-report fee in a real property transaction, that some state laws view as interest for usury purposes. Furthermore, measuring the timing of value received and of payments made, which is essential if APR calculations are to

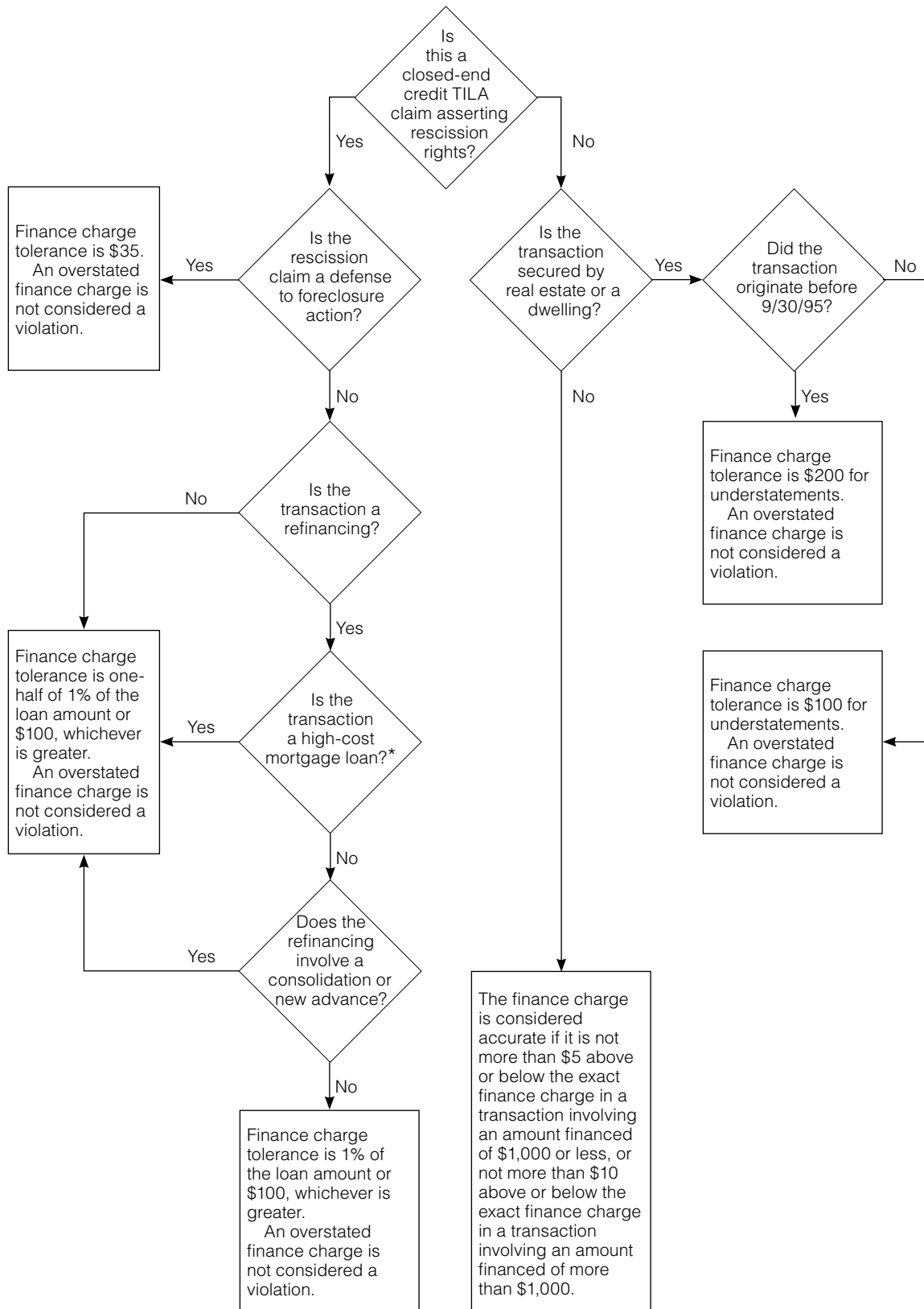
be accurate, must be consistent with parameters under Regulation Z.

The APR is often considered to be the finance charge expressed as a percentage. However, two loans could have the same finance charge and still have different APRs because of differing values of the amount financed or differing payment schedules. For example, the APR on a loan with an amount financed of \$5,000 and 36 equal monthly payments of \$166.07 each is 12 percent, while the APR on a loan with an amount financed of \$4,500 and 35 equal monthly payments of \$152.18 each, plus a final payment of \$152.22, is 13.26 percent. In both cases the finance charge is \$978.52. The APRs on these loans are not the same because an APR reflects more than the finance charge. It relates the amount and timing of value received by the consumer to the amount and timing of payments made by the consumer.

The APR is a function of

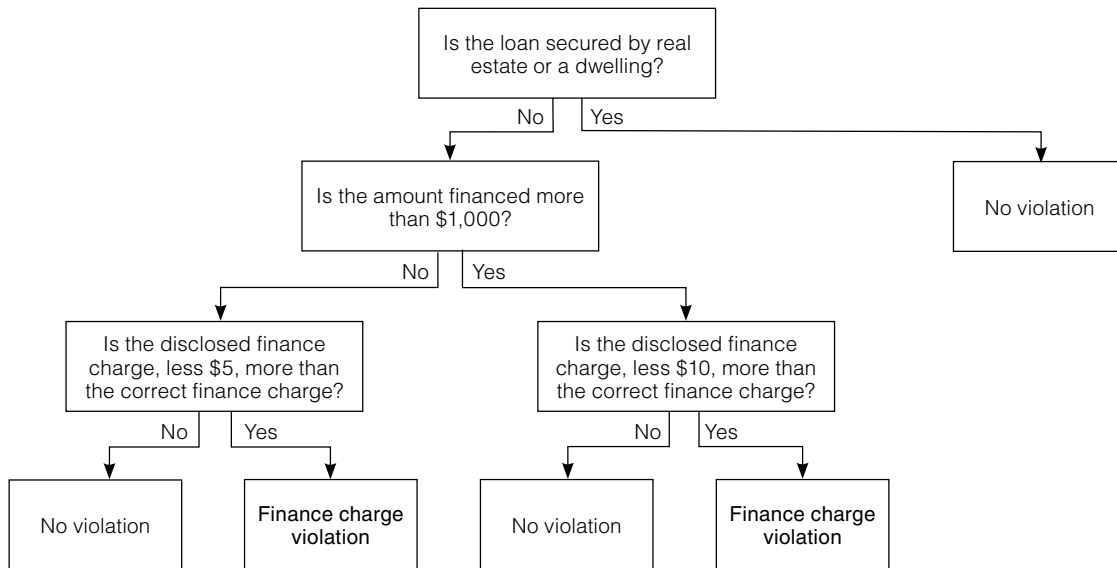
- The *amount financed*, which is not necessarily equivalent to the loan amount
  - If the consumer must pay a separate 1 percent loan origination fee (a prepaid finance charge) on a \$100,000 residential mortgage loan at closing, the loan amount is \$100,000 but the amount financed is \$100,000 less the \$1,000 loan fee, or \$99,000.
- The *finance charge*, which is not necessarily equivalent to the total interest amount
  - If the consumer must pay a \$25 credit-report fee for an auto loan, the fee must be included in the finance charge. The finance charge in this case is the sum of the interest on the loan (that is, the interest generated by the application of a percentage rate against the loan amount) plus the \$25 credit-report fee.
  - If the consumer must pay a \$25 credit-report fee for a home improvement loan secured by real property, the credit-report fee must be excluded from the finance charge. The finance charge in this case would be only the interest on the loan.
- *Interest*, which is defined by state or other federal law but not by Regulation Z
- The *payment schedule*, which does not necessarily include only principal and interest (P + I) payments
  - If the consumer borrows \$2,500 for a vacation trip at 14 percent simple interest per annum and repays that amount with 25 equal monthly payments beginning one month from consummation of the transaction, the monthly P + I

## Closed-End Credit: Accuracy Tolerances for Finance Charges



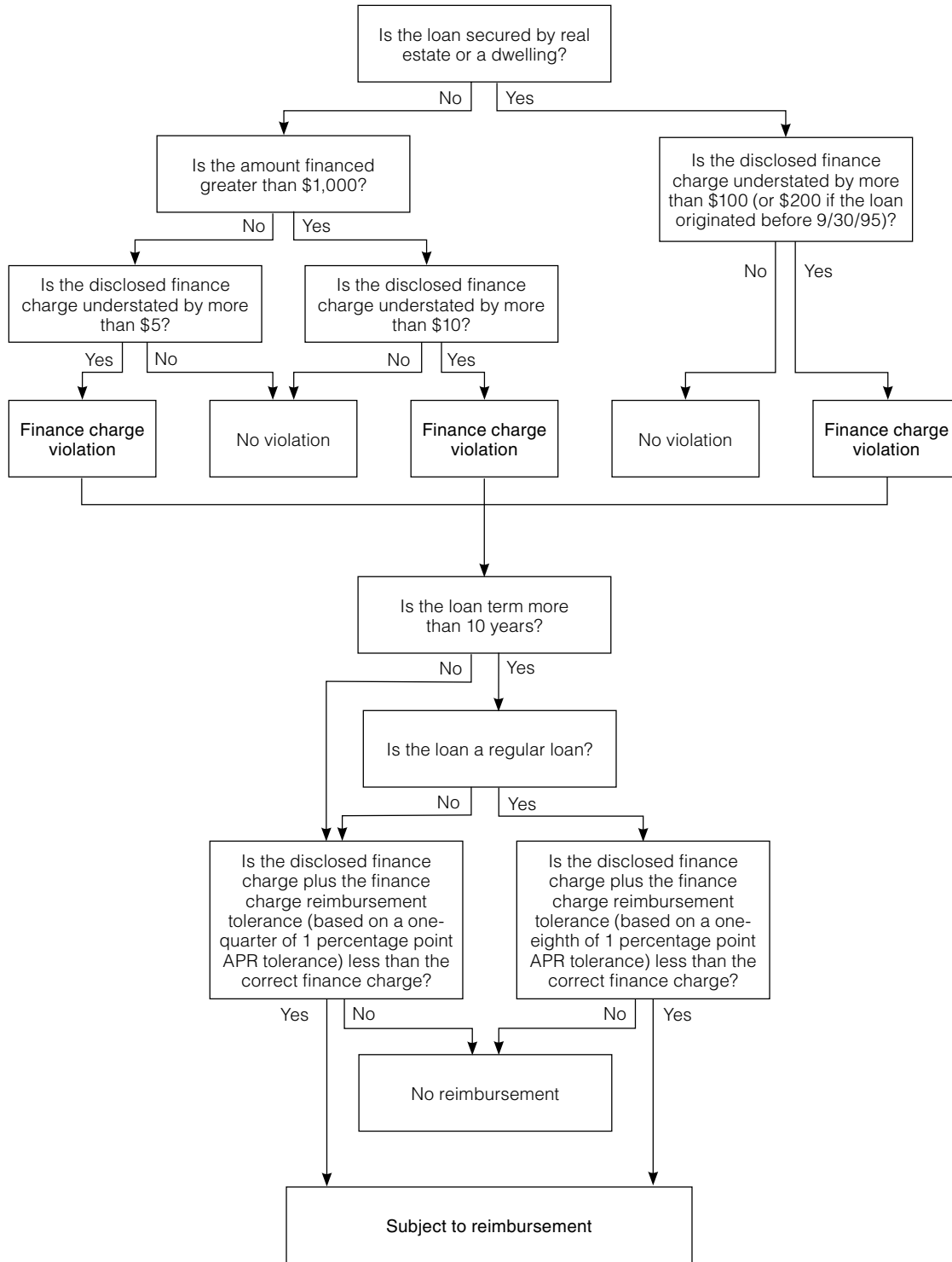
\* See 15 USC 160(aa) and 12 CFR 226.32.

### Closed-End Credit: Accuracy Tolerances for Overstated Finance Charges





## Closed-End Credit: Accuracy and Reimbursement Tolerances for Understated Finance Charges



payment would be \$115.87, if all months are considered equal, and the amount financed would be \$2,500. If the consumer's payments are increased \$2.00 a month to pay a nonfinanced \$50 loan fee over the life of the loan, the amount financed would remain at \$2,500 but the monthly payment would increase to \$117.87, the finance charge would increase \$50, and there would be a corresponding increase in the APR. This would be the case whether or not state law defines the \$50 loan fee as interest.

- If the loan in the preceding example has 55 days to the first payment and the consumer prepays interest at consummation (\$24.31 to cover the first 25 days), the amount financed would be \$2,500 less \$24.31, or \$2,475.69. Although the amount financed is reduced because the amount available to the consumer at consummation is less, the time interval during which the consumer has use of the \$2,475.69—55 days to the first payment—is unchanged. To ease creditor compliance, Regulation Z allows creditors to disregard certain minor irregularities in the first payment period (see section 226.17(c)(4)). In this case, however, because the first payment period exceeds the limitations of the regulation's "minor irregularities" provisions, the first payment period of 55 days may not be treated as "regular." In calculating the APR, the first payment period must not be reduced 25 days (that is, the first payment period may not be treated as one month).

Financial institutions may, if permitted by state or other law, precompute interest by applying a rate against a loan balance using a simple interest, add-on, discount, or other method and may earn interest using a simple-interest accrual system, the Rule of 78s (if permitted by law), or some other method. Unless the financial institution's internal interest earnings and accrual methods involve a simple interest rate based on a 360-day year that is applied over actual days (important only for determining the accuracy of the payment schedule), the institution's method of earning interest is not relevant in calculating an APR, because an APR is not an interest rate (as that term is commonly used under state or other law). As the APR normally need not rely on the internal accrual systems of a financial institution, it may always be computed after the loan terms have been agreed on (as long as it is disclosed before actual consummation of the transaction).

## Special Requirements for Calculating the Finance Charge and APR

Proper calculation of the finance charge and APR is very important. Regulation Z requires that the terms "finance charge" and "annual percentage rate," when required to be disclosed with a corresponding amount or percentage rate, be disclosed more conspicuously than any other required disclosure. The finance charge and APR, more than any other disclosures, enable consumers to understand the cost of the credit and to comparison shop for credit. Failure to disclose those values accurately can result in significant monetary damages to the creditor, either from a class action lawsuit or from a regulatory agency's order to reimburse consumers for violations of law.

Footnote 45d to section 226.22 states that if an annual percentage rate or finance charge is disclosed incorrectly, the error is not, in itself, a violation of the regulation if

- The error resulted from a corresponding error in a calculation tool used in good faith by the financial institution
- Upon discovery of the error, the financial institution promptly discontinues use of that calculation tool for disclosure purposes
- The financial institution notifies the Federal Reserve Board in writing of the error in the calculation tool

When a financial institution claims that it used a calculation tool in good faith, it assumes a reasonable degree of responsibility for ensuring that the tool in question provides the accuracy required by the regulation. To check on the tool's accuracy, the institution might verify the results obtained using the tool with figures obtained using a different calculation tool. It might also check that the tool, if it is designed to operate under the actuarial method, produces figures similar to those provided by the examples in appendix J to the regulation. The calculation tool should be checked for accuracy before it is first used and periodically thereafter.

## Open-End Credit (Subpart B)

This discussion does not address all the requirements for open-end credit in the Truth in Lending Act and Regulation Z. Instead, it focuses on some of the more difficult issues presented in sections 226.5 through 226.16 of the regulation. Additional guidance is provided in the commentary for these sections.

## Finance Charge (§ 226.6(a))

Each finance charge imposed must be individually itemized. An aggregate amount of the finance charge need not be disclosed.

### *Determining the Balance and Computing the Finance Charge*

To compute the finance charge, the examiner must know how to determine the balance to which the periodic rate is applied. Common methods are the previous balance method, the daily balance method, and the average daily balance method.

- *Previous balance method*—The balance to which the periodic rate is applied is the balance outstanding at the start of the billing cycle. The periodic rate is multiplied by this balance to compute the finance charge.
- *Daily balance method*—The balance to which the periodic rate is applied is either the balance on each day in the billing cycle or the sum of the balances on each day in the cycle. If a daily periodic rate is multiplied by the balance on each day in the billing cycle, the finance charge is the sum of the products. If the daily periodic rate is multiplied by the sum of all the daily balances, the finance charge is the product.
- *Average daily balance method*—The balance to which the periodic rate is applied is the sum of the daily balances (either including or excluding current transactions) divided by the number of days in the billing cycle. The periodic rate is multiplied by the average daily balance to determine the finance charge. If the periodic rate is a daily rate, the product of the rate multiplied by the average balance is multiplied by the number of days in the cycle.

In addition to those common methods, financial institutions have other ways of calculating the balance to which the periodic rate is applied. By reading the institution's explanation, the examiner should be able to calculate the balance to which the periodic rate was applied. In some cases the examiner may need to obtain additional information from the institution to verify the explanation disclosed. Any inability to understand the disclosed explanation should be discussed with management, who should be reminded of Regulation Z's requirement that disclosures be clear and conspicuous.

If the balance is determined without first deducting all credits given and payments made during the billing cycle, that fact, as well as the amounts of the credits and payments, must be disclosed.

If the financial institution uses the daily balance method and applies a single daily periodic rate,

disclosure of the balance to which the rate was applied may be stated as any of the following:

- *A balance for each day in the billing cycle*—The daily periodic rate is multiplied by the balance on each day, and the sum of the products is the finance charge.
- *A balance for each day in the billing cycle on which the balance in the account changes*—The daily periodic rate is multiplied by the balance on each day, and the sum of the products is the finance charge, as above, but the statement shows the balance for only those days on which the balance changed.
- *The sum of the daily balances during the billing cycle*—The daily periodic rate is multiplied by the sum of all the daily balances in the billing cycle, and that product is the finance charge.
- *The average daily balance during the billing cycle*—If this balance is the one disclosed, the institution must explain somewhere on the periodic statement or in an accompanying document that the finance charge is or may be determined by multiplying the average daily balance by the number of days in the billing cycle rather than by multiplying the product by the daily periodic rate.

If the financial institution uses the daily balance method but applies two or more daily periodic rates, the sum of the daily balances may not be used. Acceptable ways of disclosing the balances include

- *A balance for each day in the billing cycle*
- *A balance for each day in the billing cycle on which the balance in the account changed*
- *Two or more average daily balances*—If the balance is disclosed in this way, the institution must indicate on the periodic statement or in an accompanying document that the finance charge is or may be determined by (1) multiplying each of the average daily balances by the number of days in the billing cycle (or if the daily rate varies, multiplying the number of days that the applicable rate was in effect), (2) multiplying each of the results by the applicable daily periodic rate, and (3) summing the products.

In explaining the method used to determine the balance on which the finance charge is computed, the financial institution need not reveal how it allocates payments or credits. That information may be disclosed as additional information, but all required information must be clear and conspicuous.

### *Finance Charge Resulting from Two or More Periodic Rates*

Some financial institutions use more than one periodic rate in computing the finance charge. For example, one rate may apply to balances up to a certain amount and another rate to balances over that amount. If two or more periodic rates apply, the institution must disclose all rates and conditions. The range of balances to which each rate applies must also be disclosed. It is not necessary, however, to break the finance charge into separate components based on the different rates.

### Annual Percentage Rate

#### *Accuracy Tolerance (§ 226.14)*

The disclosed annual percentage rate on an open-end credit account is considered accurate if it is within one-eighth of 1 percentage point of the APR calculated under Regulation Z.

#### *Determining the APR*

Regulation Z describes two basic methods for determining the APR in open-end credit transactions. One method involves multiplying each periodic rate by the number of periods in a year. This method is used for disclosing

- The corresponding APR in initial disclosures
- The corresponding APR on periodic statements
- The APR in early disclosures for credit card accounts
- The APR in early disclosures for home equity plans
- The APR in advertising
- The APR in oral disclosures

The corresponding APR is prospective. In other words, it is not based on the account's actual outstanding balance and the finance charges that are imposed.

The other method is the quotient method, used in computing the APR for periodic statements. The quotient method reflects the annualized equivalent of the rate that was actually applied during a cycle. This rate, also known as the historical APR, will differ from the corresponding APR if the creditor applies minimum, fixed, or transaction charges to the account during the cycle.

If the finance charge is determined by applying one or more periodic rates to a balance and does not include any of those charges (minimum, fixed, or transaction), the financial institution may compute the historical rate using the quotient method. In the quotient method, the total finance charge for the cycle is divided by the sum of the balances to

which the periodic rates were applied, and the quotient (expressed as a percentage) is multiplied by the number of cycles in a year.

Alternatively, the financial institution may compute the historical APR using the method for computing the corresponding APR. In that method, each periodic rate is multiplied by the number of periods in one year. If the finance charge includes a minimum, fixed, or transaction charge, the institution must use the appropriate variation of the quotient method. When transaction charges are imposed, the financial institution should refer to appendix F to Regulation Z for computational examples.

Regulation Z also contains a computation rule for small finance charges. If the finance charge includes a minimum, fixed, or transaction charge and the total finance charge for the cycle does not exceed 50 cents, the financial institution may multiply each applicable periodic rate by the number of periods in a year to compute the APR.

Regulation Z also provides optional calculation methods for accounts involving daily periodic rates (see section 226.14(d)).

#### *Calculating the APR for Periodic Statements*

*Note: Assume monthly billing cycles for each of the calculations.*

- I. APR when finance charge is determined solely by applying one or more periodic rates
  - A. Monthly periodic rates
    1. Monthly rate  $\times$  12 = APR  
*or*
    2. (Total finance charge  $\div$  Applicable balance)  $\times$  12 = APR<sup>2</sup>  
The preceding calculations may be used when different rates apply to different balances.
  - B. Daily periodic rates
    1. Daily rate  $\times$  365 = APR  
*or*
    2. (Total finance charge  $\div$  Average daily balance)  $\times$  12 = APR  
*or*
    3. (Total finance charge  $\div$  Sum of balances)  $\times$  365 = APR
- II. APR when finance charge includes a minimum, fixed, or other charge that is not calculated using a periodic rate (and does not include charges related to a specific transaction, such as a cash advance fee)
  - A. Monthly periodic rates

<sup>2</sup> If the applicable balance is zero, the APR cannot be determined.

1.  $(\text{Total finance charge} \div \text{Amount of applicable balance}^3) \times 12 = \text{APR}^4$
- B. Daily periodic rates
  1.  $(\text{Total finance charge} \div \text{Amount of applicable balance}) \times 365 = \text{APR}^{5, 6}$
  2. The following may be used if at least a portion of the finance charge is determined by the application of a daily periodic rate. If not, use the formula above.
    - a.  $(\text{Total finance charge} \div \text{Average daily balance}) \times 12 = \text{APR}^7$   
or
    - b.  $(\text{Total finance charge} \div \text{Sum of balances}) \times 365 = \text{APR}^8$
- C. Monthly and daily periodic rates
  1. If the finance charge imposed during the billing cycle does not exceed 50 cents for a monthly or longer billing cycle (or a prorated part of 50 cents for a billing cycle shorter than one month), the APR may be calculated by multiplying the monthly rate by 12 or the daily rate by 365.
- III. If the total finance charge includes a charge related to a specific transaction (such as a cash advance fee), even if the total finance charge also includes any other minimum, fixed, or other charge not calculated using a periodic rate, then the monthly and daily APRs are calculated as follows:  $(\text{Total finance charge} \div \text{The greater of (1) the transaction amounts that created the transaction fees or (2) the sum of the balances and other amounts on which a finance charge was imposed during the billing cycle}^9) \times \text{number of billing cycles in a year (12)} = \text{APR}^{10}$

### Closed-End Credit (Subpart C)

The information presented here does not provide a complete discussion of the closed-end credit requirements of the Truth in Lending Act. Instead, it is offered to clarify otherwise confusing terms and

3. See footnote 2.

4. Loan fees, points, or similar finance charges that relate to the opening of the account must not be included in the calculation of the APR.

5. See footnote 2.

6. See footnote 4.

7. See footnote 2.

8. See footnote 2.

9. The sum of the balances may include amounts computed by either the average daily balance, adjusted balance, or previous balance method. When a portion of the finance charge is determined by application of one or more daily periodic rates, the sum of the balances also means the average of daily balances.

10. If the product is less than the highest periodic rate applied, expressed as an APR, the higher figure must be disclosed as the APR.

requirements. Refer to sections 226.17 through 226.24 of Regulation Z and related commentary for a more thorough understanding of the act.

### Finance Charge (§ 226.17(a))

The total amount of the finance charge must be disclosed. Each finance charge imposed need not be individually itemized and must not be itemized with the segregated disclosures.

### Annual Percentage Rate (§ 226.22)

#### Accuracy Tolerances

The disclosed APR on a closed-end transaction is considered accurate

- If for *regular transactions* (including any single-advance transaction with equal payments and equal payment periods or transactions with an irregular first or last payment and/or an irregular first payment period), the APR is within one-eighth of 1 percentage point of the APR calculated under Regulation Z (section 226.22(a)(2))
- If for *irregular transactions* (including multiple-advance transactions and other transactions not considered regular), the APR is within one-quarter of 1 percentage point of the APR calculated under Regulation Z (section 226.22(a)(3))
- If for *mortgage transactions*, the APR is within one-eighth of 1 percentage point for regular transactions or one-quarter of 1 percentage point for irregular transactions *and*
  - The rate results from the disclosed finance charge and
  - The disclosed finance charge would be considered accurate under section 226.18(d)(1) or section 226.23(g) or (h) of Regulation Z (section 226.22(a)(4))

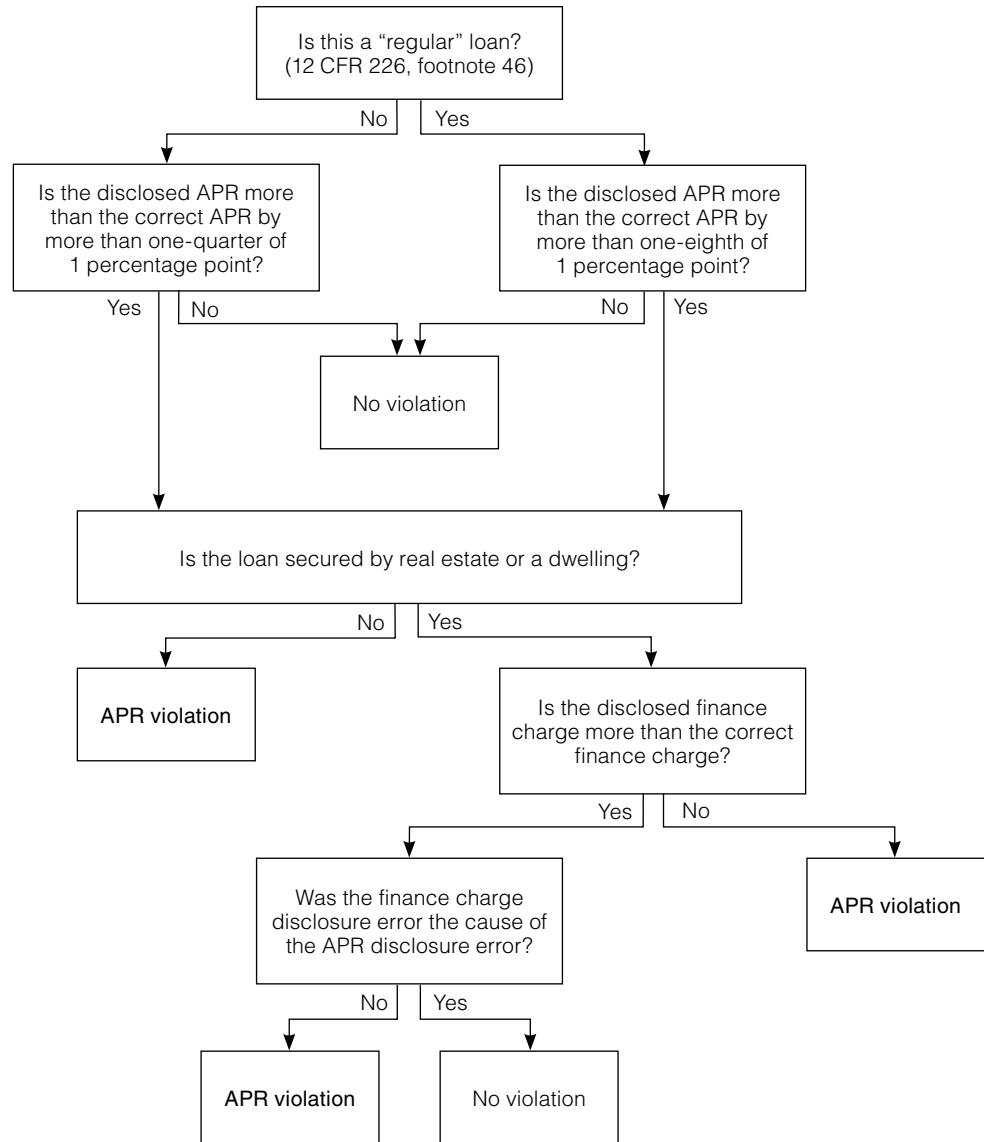
Note: An additional tolerance is granted for mortgage loans when the disclosed finance charge is calculated incorrectly but is considered accurate under section 226.18(d)(1) or section 226.23(g) or (h) of Regulation Z (section 226.22(a)(5)).

See the diagrams for more information on accuracy tolerances.

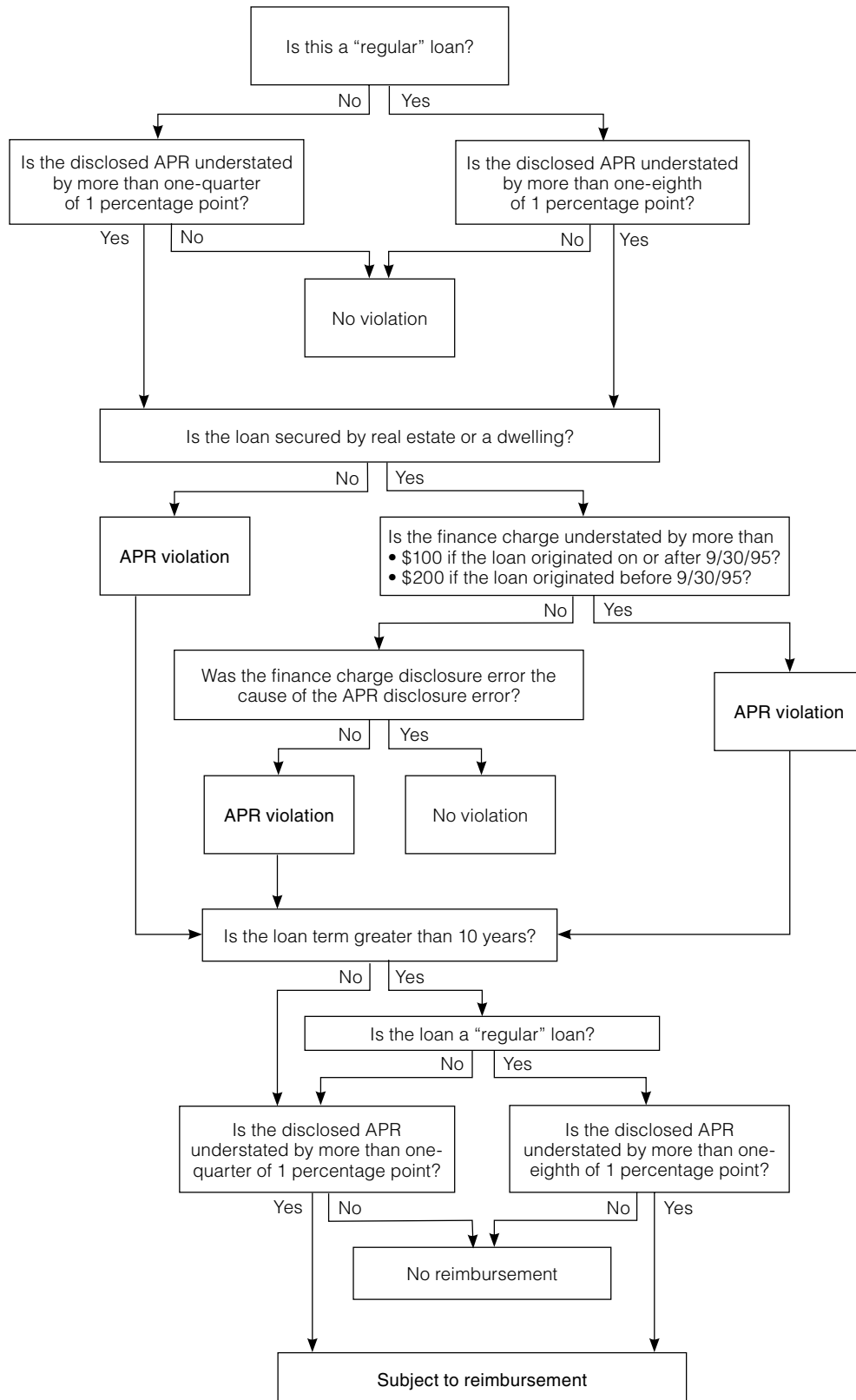
### Construction Loans (§ 226.17(c)(6) and Appendix D)

Construction loans and certain other multiple-advance loans pose special problems in computing the finance charge and the APR. In many instances, the amount and dates of advances are not predictable with certainty because they depend

Closed-End Credit: Accuracy Tolerances for Overstated APRs



## Closed-End Credit: Accuracy and Reimbursement Tolerances for Understated APRs



on the progress of the work. Regulation Z provides that, for disclosure purposes, the APR and finance charge for such loans may be estimated.

A financial institution may, at its option, rely on the representations of other parties to acquire necessary information (for example, it might look to the consumer for the dates of advances). In addition, if any of the amounts or the dates of advances are unknown (even if some of them are known), the institution may, at its option, refer to appendix D to the regulation to make calculations and disclosures. The finance charge and payment schedule obtained by referring to appendix D may be used with volume 1 of the Board's APR tables or with any other appropriate computation tool to determine the APR (the Board's APR tables are available through the System publications catalog on the New York Reserve Bank's web site). If the institution elects not to use appendix D, or if appendix D cannot be applied to a loan (for example, appendix D does not apply to a combined construction-permanent loan if the payments for the permanent loan begin during the construction period), the institution must make its estimates under section 226.17(c)(2) and calculate the APR using multiple-advance formulas.

For loans involving a series of advances under an agreement to extend credit up to a certain amount, a financial institution may treat all the advances as a single transaction or disclose each advance as a separate transaction. If advances are disclosed separately, disclosures must be provided before each advance occurs, and the disclosures for the first advance must be provided before consummation.

In a transaction that finances the construction of a dwelling that may or will be permanently financed by the same financial institution, the construction-permanent financing phases may be disclosed in one of the following ways:

- As a single transaction, with one disclosure covering both phases
- As two separate transactions, with one disclosure for each phase
- As more than two transactions, with one disclosure for each advance and one for the permanent-financing phase

If two or more disclosures are furnished, buyer's points or similar amounts imposed on the consumer may be allocated among the transactions in any manner the financial institution chooses, as long as the charges are not applied more than once. In addition, if the financial institution chooses to give two sets of disclosures and the consumer is obligated for both construction and permanent phases at the outset, both sets of disclosures must

be given to the consumer initially, before consummation of each transaction occurs.

If the creditor requires interest reserves for construction loans, special rules set forth in appendix D to Regulation Z apply that can make the disclosure calculations quite complicated. The amount of interest reserves included in the commitment amount must not be treated as a prepaid finance charge.

If the lender uses appendix D for construction-only loans with required interest reserves, construction interest must be estimated using the interest-reserve formula in appendix D. The lender's own interest-reserve values must be completely disregarded for disclosure purposes.

If the lender uses appendix D for combination construction-permanent loans, the calculations can be much more complex. The appendix is used to estimate the construction interest, which is then measured against the lender's contractual interest reserves.

If the interest-reserve portion of the lender's contractual-commitment amount exceeds the amount of construction interest estimated under appendix D, the excess value is considered part of the amount financed if the lender has contracted to disburse those amounts, whether or not they ultimately are needed to pay for accrued construction interest. If the lender will not disburse the excess amount if it is not needed to pay for accrued construction interest, the excess amount must be ignored for disclosure purposes.

### Calculating the Annual Percentage Rate (§ 226.22)

The APR must be determined under one of the following methods:

- The actuarial method, which is defined by Regulation Z and explained in appendix J to the regulation
- The U.S. Rule, which is permitted by Regulation Z and is briefly explained in appendix J to the regulation (The U.S. Rule is an accrual method that seems to have first surfaced officially in an early nineteenth century U.S. Supreme Court case, *Story v. Livingston* (38 U.S. 359).)

Whichever method the financial institution uses, the rate calculated will be considered accurate if it is able to "amortize" the amount financed while generating the finance charge under the accrual method selected. Institutions also may rely on minor irregularities and accuracy tolerances in the regulation, both of which effectively permit the disclosure of somewhat imprecise, but still legal, APRs.



### 360-Day and 365-Day Years (§ 226.17(c)(3))

Confusion often arises over whether to use a 360-day or 365-day year in computing interest, particularly when the finance charge is computed by applying a daily rate to an unpaid balance. Many single-payment loans and loans payable on demand are in this category. Also in this category are loans that call for periodic installment payments.

Regulation Z does not require the use of one method of interest computation in preference to another (although state law may). It does, however, permit financial institutions to disregard the fact that months have different numbers of days when calculating and making disclosures. This means that financial institutions may base their disclosures on calculation tools that assume that all months have an equal number of days, even if their practice is to take account of the variations in months to collect interest. For example, an institution may calculate disclosures using a financial calculator based on a 360-day year with 30-day months when, in fact, it collects interest by applying a factor of  $\frac{1}{365}$  of the annual interest rate to actual days.

Disclosure violations may occur, however, when a financial institution applies a daily interest factor based on a 360-day year to the actual number of days between payments. In those situations, the institution must disclose the higher values of the finance charge, the APR, and the payment schedule resulting from this practice. For example, a 12 percent simple interest rate divided by 360 days results in a daily rate of .033333 percent. If no charges are imposed except interest and the amount financed is the same as the loan amount, applying the daily rate on a daily basis for a 365-day year on a \$10,000 one-year, single-payment, unsecured loan results in an APR of 12.17 percent ( $.033333 \times 365 = 12.17$ ) and a finance charge of \$1,216.67. There would be a violation if the APR were disclosed as 12 percent or the finance charge were disclosed as \$1,200 ( $12\% \times \$10,000$ ). However, if no other charges except interest are imposed, the application of a 360-day-year daily rate over 365 days on a regular loan would not result in an APR in excess of the one-eighth of 1 percentage point APR tolerance unless the nominal interest rate is greater than 9 percent. For irregular loans, with one-quarter of 1 percentage point APR tolerance, the nominal interest rate would have to be greater than 18 percent to exceed the tolerance.

### Variable-Rate Loans (§ 226.18(f))

If the terms of the legal obligation allow the financial institution, after consummation of the transaction, to

increase the APR, the financial institution must furnish the consumer with certain information on variable rates. Graduated-payment mortgages and step-rate transactions without a variable-rate feature are not considered variable-rate transactions. In addition, variable-rate disclosures are not applicable to rate increases resulting from delinquency, default, assumption, acceleration, or transfer of the collateral. Some of the more important transaction-specific variable-rate disclosure requirements under section 226.18 follow:

- Disclosures for variable-rate loans must cover the full term of the transaction and must be based on the terms in effect at the time of consummation.
- If the variable-rate transaction includes either a seller buydown that is reflected in a contract or a consumer buydown, the disclosed APR should be a composite rate based on the lower rate for the buydown period and the rate that is the basis for the variable-rate feature for the remainder of the term.
- If the initial rate is not determined by the index or formula used to make later interest rate adjustments, as in a discounted variable-rate transaction, the disclosed APR must reflect a composite rate based on the initial rate for as long as it is applied and, for the remainder of the term, the rate that would have been applied using the index or formula at the time of consummation (that is, the fully indexed rate).
  - If a loan contains a rate or payment cap that would prevent the initial rate or payment, at the time of the adjustment, from changing to the fully indexed rate, the effect of that rate or payment cap needs to be reflected in the disclosure.
  - The index at consummation need not be used if the contract provides for a delay in implementation of changes in an index value (for example, the contract indicates that future rate changes are based on the index value in effect for some specified period, such as forty-five days before the change date). Instead, the financial institution may use any rate from the date of consummation back to the beginning of the specified period (for example, during the previous forty-five-day period).
- If the initial interest rate is set according to the index or formula used for later adjustments but is set at a value as of a date before consummation, disclosures should be based on the initial interest rate, even though the index may have changed by the consummation date.

For variable-rate consumer loans that are *not* secured by the consumer's principal dwelling or

that are secured by the consumer's principal dwelling but have a term of one year or less, creditors must disclose the circumstances under which the rate may increase, any limitations on the increase, the effect of an increase, and an example of the payment terms that would result from an increase (section 226.18(f)(1)).

For variable-rate consumer loans that *are* secured by the consumer's principal dwelling and have a maturity of more than one year, creditors must state that the loan has a variable-rate feature and that disclosures were previously given (section 226.18(f)(2)). Extensive disclosures about the loan program must be provided when consumers apply for such a loan (section 226.19(b)) and throughout the loan term when the rate or payment amount is changed (section 226.20(c)).

### Payment Schedule (§ 226.18(g))

The disclosed payment schedule must reflect all components of the finance charge, including all scheduled payments to repay loan principal, interest on the loan, and any other finance charge payable by the consumer after consummation of the transaction. Any finance charge paid separately before or at consummation (for example, odd days' interest) is not to be treated as part of the payment schedule; it is a prepaid finance charge and must be reflected as a reduction in the value of the amount financed.

At the creditor's option, the payment schedule may include amounts beyond the amount financed and the finance charge (for example, certain insurance premiums or real estate escrow amounts, such as taxes added to payments). However, the creditor must disregard such amounts when calculating the APR.

If the obligation is a renewable balloon-payment instrument that unconditionally obligates the financial institution to renew the short-term loan at the consumer's option or to renew the loan subject to conditions within the consumer's control, the payment schedule must be disclosed using the longer term of the renewal period or periods. The variable-rate feature for the long-term loan must be disclosed.

If the instrument has no renewal conditions or the financial institution guarantees to renew the obligation in a refinancing, the payment schedule must be disclosed using the shorter balloon-payment term. The short-term loan must be disclosed as a fixed-rate loan, unless it contains a variable-rate feature during the initial loan term.

### Amount Financed (§ 226.18(b))

#### *Definition*

The *amount financed* is the net amount of credit extended for the consumer's use. It should not be assumed that under the regulation, the amount financed is equivalent to the note amount, the proceeds, or the principal amount of the loan. The amount financed normally equals the total of payments less the finance charge.

To calculate the amount financed, all amounts and charges connected with the transaction, either paid separately or included in the note amount, must first be identified. Any prepaid, precomputed, or other finance charge must then be determined.

*The amount financed must not include any finance charges.* If finance charges have been included in the obligation (either prepaid or precomputed), they must be subtracted from the face amount of the obligation when determining the amount financed. The resulting value must be reduced further by an amount equal to any prepaid finance charge paid separately. The final resulting value is the amount financed.

When calculating the amount financed, finance charges (whether in the note amount or paid separately) should not be subtracted more than once from the total amount of an obligation. Charges not in the note amount and not included in the finance charge (for example, an appraisal fee paid separately, in cash, on a real estate loan) need not be disclosed under Regulation Z and must not be included in the amount financed.

In a multiple-advance construction loan, proceeds placed in a temporary escrow account and awaiting disbursement to the developer in draws are not considered part of the amount financed until they are actually disbursed. Thus, if the entire commitment amount is disbursed into the lender's escrow account, the lender must not base disclosures on the assumption that all funds were disbursed immediately, even if the lender pays interest on the escrowed funds.

#### *Required Deposit (§ 226.18(r))*

A *required deposit*, with certain exceptions, is one that the financial institution requires the consumer to maintain as a condition of the specific credit transaction. It can include a compensating balance or a deposit balance that secures the loan. The effect of a required deposit is not reflected in the APR. Also, a required deposit is not a finance charge, as it is eventually released to the consumer. A deposit that earns at least 5 percent per year need not be considered a required deposit.

### *Calculating the Amount Financed*

Suppose that a consumer signs a note secured by real property in the amount of \$5,435. The note amount includes \$5,000 in proceeds disbursed to the consumer, \$400 in precomputed interest, \$25 paid to a credit-reporting agency for a credit report, and a \$10 service charge. Additionally, the consumer pays a \$50 loan fee separately, in cash, at consummation. The consumer has no other debt with the financial institution. The amount financed is \$4,975.

The amount financed may be calculated by first subtracting all finance charges included in the note amount ( $\$5,435 - \$400 - \$10 = \$5,025$ ). The \$25 credit-report fee is not a finance charge because the loan is secured by real property. The \$5,025 is further reduced by the amount of prepaid finance charges paid separately, for an amount financed of  $\$5,025 - \$50 = \$4,975$ . The answer is the same whether finance charges included in the obligation are considered prepaid or precomputed finance charges.

The financial institution may treat the \$10 service charge as an addition to the loan amount and not as a prepaid finance charge. If it does, the loan principal would be \$5,000. The \$5,000 loan principal does not include either the \$400 or the \$10 precomputed finance charge in the note. The loan principal is increased by other amounts financed that are not part of the finance charge (the \$25 credit-report fee) and reduced by any prepaid finance charges (the \$50 loan fee, but not the \$10 service charge) to arrive at the amount financed of  $\$5,000 + \$25 - \$50 = \$4,975$ .

### *Other Calculations*

In the preceding example, the financial institution may treat the \$10 service charge as a prepaid finance charge. If it does, the loan principal would be \$5,010. The \$5,010 loan principal does not include the \$400 precomputed finance charge. The loan principal is increased by other amounts financed that are not part of the finance charge (the \$25 credit-report fee) and reduced by any prepaid finance charges (the \$50 loan fee and the \$10 service charge withheld from the loan proceeds) to arrive at the same amount financed of  $\$5,010 + \$25 - \$50 - \$10 = \$4,975$ .

### Refinancings (§ 226.20)

When an obligation is satisfied and replaced by a new obligation to the original financial institution (or a holder or servicer of the original obligation) and is undertaken by the same consumer, it must be treated as a refinancing for which a complete set of new disclosures must be furnished. A refinancing

may involve the consolidation of several existing obligations, disbursement of new money to the consumer, or the rescheduling of payments under an existing obligation. In any form, the new obligation must completely replace the earlier one to be considered a refinancing under Regulation Z. The finance charge on the new disclosure must include any unearned portion of the old finance charge that is not credited to the existing obligation (section 226.20(a)).

The following transactions are not considered refinancings even if the existing obligation has been satisfied and replaced by a new obligation undertaken by the same consumer:

- A renewal of an obligation with a single payment of principal and interest or with periodic interest payments and a final payment of principal with no change in the original terms
- An APR reduction with a corresponding change in the payment schedule
- An agreement involving a court proceeding
- Changes in credit terms arising from the consumer's default or delinquency
- The renewal of optional insurance purchased by the consumer and added to an existing transaction, if required disclosures were provided for the initial purchase of the insurance

However, even if it is not accomplished by the cancellation of the old obligation and substitution of a new one, a new transaction subject to new disclosures results if the financial institution does either of the following:

- Increases the rate based on a variable-rate feature that was not previously disclosed
- Adds a variable-rate feature to the obligation

If the rate is increased at the time a loan is renewed, the increase is not considered a variable-rate feature. It is the cost of renewal, similar to a flat fee, as long as the new rate remains fixed during the remaining life of the loan. If the original debt is not canceled in connection with such a renewal, new disclosures are not required. Also, changing the index of a variable-rate transaction to a comparable index is not considered adding a variable-rate feature to the obligation.

### Miscellaneous Provisions (Subpart D)

#### Civil Liability (TILA § 130)

If a creditor fails to comply with any requirements of the TILA, other than with the advertising provisions of chapter 3, it may be held liable to the consumer for both

- Actual damage

- The cost of any legal action together with reasonable attorney's fees in a successful action

If the creditor violates certain requirements of the TILA, it may also be held liable for either of the following:

- In an individual action, twice the amount of the finance charge involved, but not less than \$100 or more than \$1,000. However, in an individual action relating to a closed-end credit transaction secured by real property or a dwelling, twice the amount of the finance charge involved, but not less than \$200 or more than \$2,000.
- In a class action, such amount as the court may allow. However, the total amount of recovery may not be more than \$500,000 or 1 percent of the creditor's net worth, whichever is less.

Civil actions that may be brought against a creditor may also be maintained against any assignee of the creditor if the violation is apparent on the face of the disclosure statement or other documents assigned, except when the assignment was involuntary.

A creditor that fails to comply with the TILA's requirements for high-cost mortgage loans may be held liable to the consumer for all finance charges and fees paid to the creditor. Any subsequent assignee is subject to all claims and defenses that the consumer could assert against the creditor, unless the assignee demonstrates that it could not reasonably have determined that the loan was subject to section 226.32 of Regulation Z.

### Criminal Liability (TILA § 112)

Anyone who willingly and knowingly fails to comply with any requirement of the TILA will be fined not more than \$5,000 or imprisoned not more than one year, or both.

### Administrative Actions (TILA § 108)

The TILA authorizes federal regulatory agencies to require financial institutions to make monetary and other adjustments to a consumer's account when the true finance charge or APR exceeds the disclosed finance charge or APR by more than a specified accuracy tolerance. That authorization extends to unintentional errors, including isolated violations (for example, an error that occurred only once or errors, often without a common cause, that occurred infrequently and randomly).

Under certain circumstances, the TILA requires federal regulatory agencies to order financial institutions to reimburse consumers when understatement of the APR or finance charge involves

- Patterns or practices of violations (for example,

errors that occurred, often with a common cause, consistently or frequently, reflecting a pattern in relation to a specific type or types of consumer credit)

- Gross negligence
- Willful noncompliance intended to mislead the person to whom the credit was extended

Any proceeding that may be brought by a regulatory agency against a creditor may be maintained against any assignee of the creditor if the violation is apparent on the face of the disclosure statement or other documents assigned, except when the assignment was involuntary (TILA section 131).

Federal Reserve examiners follow the FFIEC's interagency Regulation Z policy guide when determining the applicability and amount of any reimbursements. Although the policy guide appears to require reimbursement only in cases in which a pattern or practice was discovered, System policy requires banks to make reimbursements when isolated cases are discovered as well. Unlike the discovery of a pattern or practice of violations, which requires the bank to conduct a file search to determine the extent of the pattern or practice, the discovery of an isolated instance does not require a file search. Isolated violations are technical and nonsubstantive in nature, are not cited in the examination report, and may be communicated in an informal manner.

### Relationship to State Law (TILA § 111)

State laws providing rights, responsibilities, or procedures for consumers or financial institutions for consumer credit contracts may be

- Preempted by federal law
- Appropriate under state law and not preempted by federal law
- Substituted in lieu of TILA and Regulation Z requirements

State law provisions are preempted to the extent that they contradict the requirements in the following chapters of the TILA and the implementing sections of Regulation Z:

- Chapter 1, "General Provisions," which contains definitions and acceptable methods for determining finance charges and annual percentage rates. For example, a state law would be preempted if it required a bank to include in the finance charge any fees that the federal law excludes, such as seller's points.
- Chapter 2, "Credit Transactions," which contains disclosure requirements, rescission rights, and certain credit card provisions. For example, a

state law would be preempted if it required a bank to use the term “nominal annual interest rate” in lieu of “annual percentage rate.”

- Chapter 3, “Credit Advertising,” which contains rules for consumer credit advertising and requirements for the oral disclosure of annual percentage rates.

Conversely, state law provisions may be appropriate and are not preempted under federal law if they call for, without contradicting chapters 1, 2, or 3 of the TILA or the implementing sections of Regulation Z, either of the following:

- Disclosure of information not otherwise required. A state law that requires disclosure of the minimum periodic payment for open-end credit, for example, would not be preempted because it does not contradict federal law.
- Disclosures more detailed than those required. A state law that requires itemization of the amount financed, for example, would not be preempted, unless it contradicts federal law by requiring the itemization to appear with the disclosure of the amount financed in the segregated closed-end credit disclosures.

Two preemption standards apply to TILA chapter 4. One applies to section 161 (Correction of Billing Errors) and 162 (Regulation of Credit Reports), the other to the remaining provisions of chapter 4 (sections 163–171).

State law provisions are preempted if they differ from the rights, responsibilities, or procedures contained in section 161 or 162 of the TILA. An exception is made, however, for state law that allows a consumer to inquire about an account and requires the bank to respond to such inquiry beyond the time limits provided by federal law. Such a state law would not be preempted for the extra time period.

State law provisions are preempted if they result in violations of sections 163 through 171 of chapter 4 of the TILA. For example, a state law that allows the card issuer to offset the consumer’s credit card indebtedness against funds held by the card issuer would be preempted, as it would violate section 226.12(d) of Regulation Z. Conversely, a state law that requires periodic statements to be sent more than fourteen days before the end of a free-ride period would not be preempted, as no violation of federal law is involved.

A bank, state, or other interested party may ask the Federal Reserve Board to determine whether state law contradicts chapters 1 through 3 of the TILA or Regulation Z. They may also ask if the state law is different from, or would result in violations of, chapter 4 of the TILA and the implementing provisions of Regulation Z. If the Board determines

that a disclosure required by state law (other than a requirement relating to the finance charge, the annual percentage rate, or the disclosures required under section 226.32 of the regulation) is substantially the same in meaning as a disclosure required under the act or the regulation, generally, creditors in that state may make the state disclosure in lieu of the federal disclosure.

## Special Rules for Certain Home Mortgage Transactions (Subpart E)

### General Rules (§ 226.31)

The requirements and limitations of subpart E are in addition to and not in lieu of those contained in other subparts of Regulation Z. The disclosures for high-cost and reverse mortgage transactions must be made clearly and conspicuously in writing, in a form that the consumer can keep.

### Certain Closed-End Home Mortgages (§ 226.32)

The requirements of section 226.32 apply to a consumer credit transaction secured by the consumer’s principal dwelling in which either

- The APR at consummation will exceed by more than 8 percentage points for first-lien mortgage loans, or by more than 10 percentage points for subordinate-lien mortgage loans, the yield on Treasury securities having periods of maturity comparable to the loan’s maturity (as of the 15th day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor)
- The total points and fees (see definition below) payable by the consumer at or before loan closing will exceed the greater of 8 percent of the total loan amount or a dollar amount that is adjusted annually on the basis of changes in the consumer price index (See staff commentary to section 226.32(a)(1)(ii) of Regulation Z for a historical list of dollar amount adjustments. For calendar year 2005, the dollar amount was \$510.) (section 226.32(a)(1))

### Exemptions

The following are exempt from section 226.32:

- Residential mortgage transactions (generally, purchase money mortgages)
- Reverse mortgage transactions subject to section 226.33 of Regulation Z
- Open-end credit plans subject to subpart B of the regulation

### Points and Fees

Points and fees include the following:

- All items required to be disclosed under sections 226.4(a) and (b) of Regulation Z except interest or the time-price differential
- All compensation paid to mortgage brokers
- All items listed in section 226.4(c)(7) other than amounts held for future taxes, *unless all of the following conditions are met*:
  - The charge is reasonable
  - The creditor receives no direct or indirect compensation in connection with the charge
  - The charge is not paid to an affiliate of the creditor
- Premiums or other charges, paid at or before closing whether paid in cash or financed, for optional credit life, accident, health, or loss-of-income insurance, and other debt-protection or debt-cancellation products written in connection with the credit transaction (section 226.32(b)(1))

### Reverse Mortgages (§ 226.33)

A *reverse mortgage* is a non-recourse transaction secured by the consumer's principal dwelling that ties repayment (other than upon default) to the homeowner's death or permanent move from, or transfer of the title of, the home.

## Specific Defenses—TILA Section 108

### Defense against Civil, Criminal, and Administrative Actions

A financial institution in violation of the TILA may avoid liability by doing all of the following:

- Discovering the error before an action is brought against the institution, or before the consumer notifies the institution, in writing, of the error
- Notifying the consumer of the error within sixty days of discovery
- Making the necessary adjustments to the consumer's account, also within sixty days of discovery (The consumer will pay no more than the lesser of the finance charge actually disclosed or the dollar equivalent of the APR actually disclosed.)

Taking these three actions may also allow the financial institution to avoid a regulatory order to reimburse the customer.

An error is "discovered" if it is

- Discussed in a final, written report of examination
- Identified through the financial institution's own procedures

- An inaccurately disclosed APR or finance charge included in a regulatory agency notification to the financial institution

When a disclosure error occurs, the financial institution is not required to re-disclose after a loan has been consummated or an account has been opened. If the institution corrects a disclosure error by merely re-disclosing required information accurately, without adjusting the consumer's account, the financial institution may still be subject to civil liability and an order from its regulator to reimburse.

The circumstances under which a financial institution may avoid liability under the TILA do not apply to violations of the Fair Credit Billing Act (chapter 4 of the TILA).

### Additional Defenses against Civil Actions

A financial institution may avoid liability in a civil action if it shows, by a preponderance of evidence, that the violation was not intentional and resulted from a bona fide error that occurred despite the maintenance of procedures to avoid the error.

A bona fide error may be a clerical, calculation, programming, or printing error or a computer malfunction. It does not include an error of legal judgment.

Showing that a violation occurred unintentionally could be difficult if the financial institution is unable to produce evidence that explicitly indicates that it has an internal controls program designed to ensure compliance. The financial institution's demonstrated commitment to compliance and its adoption of policies and procedures to detect errors before disclosures are furnished to consumers could strengthen its defense.

## Statute of Limitations— TILA Sections 108 and 130

Civil actions may be brought within one year after the violation occurred. After that time, and if allowed by state law, the consumer may still assert the violation as a defense if a financial institution brings an action to collect the consumer's debt. Criminal actions are not subject to the TILA one-year statute of limitations.

Regulatory administrative enforcement actions also are not subject to the one-year statute of limitations. However, enforcement actions under the FFIEC policy guide involving erroneously disclosed APRs and finance charges are subject to time limitations by the TILA. Those limitations range from the date of the most recent regulatory examination of the financial institution to as far back as 1969, depending on when the loan was made,

when the violation was identified, whether the violation was a repeat violation, and other factors.

There is no time limitation on willful violations intended to mislead the consumer. The following summarize the various time limitations:

- For open-end credit, reimbursement applies to violations not older than two years.
- For closed-end credit, reimbursement is generally applied to loans with violations occurring since the immediately preceding examination.

### Rescission Rights (Open-End and Closed-End Credit)— Sections 226.15 and 226.23

The TILA provides that for certain transactions secured by a consumer's principal dwelling, the consumer has three business days after becoming obligated on the debt to rescind the transaction. The right of rescission allows the consumer time to reexamine the credit agreement and cost disclosures and to reconsider whether he or she wants to place his or her home at risk by offering it as security for the credit. Transactions exempt from the right of rescission include residential mortgage transactions (section 226.2(a)(24)) and refinancings or consolidations with the original creditor when no "new money" is advanced.

If a transaction is rescindable, a consumer must be given a notice explaining that the creditor has a security interest in the consumer's home, that the consumer may rescind, how the consumer may rescind, the effects of rescission, and the date the rescission period expires.<sup>11</sup>

To rescind a transaction, the consumer must notify the creditor in writing by midnight of the third

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11. A creditor may provide this notice in written (paper copy) or electronic format. If a paper copy of the right to rescind is used, the creditor must deliver two copies of the notice to each consumer entitled to rescind. If an electronic format is used, the creditor may provide only one copy to each consumer entitled to rescind in accordance with the consumer-consent and other applicable provisions of the E-Sign Act.

business day after the latest of three events: (1) consummation of the transaction, (2) delivery of material TILA disclosures, or (3) receipt of the required notice of the right to rescind. For purposes of rescission, *business day* means every calendar day except Sundays and legal public holidays (section 226.2(a)(6)). *Material disclosures* is defined in section 226.23(a)(3) to mean the required disclosures of the annual percentage rate, the finance charge, the amount financed, the total of payments, the payment schedule, and the disclosures and limitations referred to in sections 226.32(c) and 226.32(d).

The creditor may not disburse any monies (except into an escrow account) and may not provide services or materials until the three-day rescission period has elapsed and the creditor is reasonably satisfied that the consumer has not rescinded. If the consumer rescinds the transaction, the creditor must refund all amounts paid by the consumer (even amounts disbursed to third parties) and terminate its security interest in the consumer's home.

A consumer may waive the three-day rescission period and receive immediate access to loan proceeds if he or she has a "bona fide personal financial emergency." The consumer must give the creditor a signed and dated waiver statement that describes the emergency, specifically waives the right, and bears the signatures of all consumers entitled to rescind the transaction. The consumer provides the explanation for the bona fide personal financial emergency, but the creditor decides the sufficiency of the emergency.

If the required rescission notice or material TILA disclosures are not delivered or if they are inaccurate, the consumer's right to rescind may be extended from three days after becoming obligated on a loan to up to three years.

# Regulation Z

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

1. To appraise the quality of the financial institution's compliance management system for the Truth in Lending Act and Regulation Z
  2. To determine the reliance that can be placed on the financial institution's compliance management system, including internal controls and procedures performed by the person(s) responsible for monitoring the financial institution's compliance review function for the Truth in Lending Act and Regulation Z
  3. To determine the financial institution's compliance with the Truth in Lending Act and Regulation Z
  4. To initiate corrective action when policies or internal controls are deficient, or when violations of law or regulation are identified
  5. To determine whether the institution will be required to make adjustments to consumer accounts under the restitution provisions of the act
- a. The procedures used address all regulatory provisions (see "Transaction Testing" section, later in these procedures)
  - b. Steps are taken to follow up on previously identified deficiencies
  - c. The procedures used include samples that cover all product types and decision centers
  - d. The work performed is accurate (by reviewing some transactions)
  - e. Significant deficiencies, and the root cause of the deficiencies, are included in reports to management and the board
  - f. Corrective actions are timely and appropriate
  - g. The area is reviewed at an appropriate interval

### EXAMINATION PROCEDURES

#### General Procedures

1. Obtain information pertinent to the area of examination from the financial institution's compliance management system program (historical examination findings, complaint information, and significant findings from compliance reviews and audits).
  2. Through discussions with management and review of the following documents, determine whether the financial institution's internal controls are adequate to ensure compliance in the area under review. Identify procedures used daily to detect errors and violations promptly. Also, review the procedures used to ensure compliance when changes occur (for example, changes in interest rates, service charges, computation methods, and software programs).
    - Organization charts
    - Process flow charts
    - Policies and procedures
    - Loan documentation and disclosures
    - Checklists, worksheets, and review documents
    - Computer programs
  3. Review compliance reviews and audit workpapers and determine whether
4. Determine whether the financial institution has changed any preprinted TILA disclosure forms or if there are forms that have not been previously reviewed for accuracy. If so, verify the accuracy of each preprinted disclosure by reviewing the following:
    - Note and/or contract forms (including those furnished to dealers)
    - Standard closed-end credit disclosures (§§ 226.17(a) and 226.18)
    - ARM disclosures (§ 226.19(b))
    - High-cost mortgage disclosures (§ 226.32(c))
    - Initial disclosures (§§ 226.6(a)–(d)) and, if applicable, additional home equity line of credit (HELC) disclosures (§ 226.6(e))
    - Credit card application and solicitation disclosures (§§ 226.5a(b)–(e))
    - HELC disclosures (§§ 226.5b(d) and 226.5b(e))
    - Statement of billing rights and change-in-terms notice (§ 226.9(a))
    - Reverse mortgage disclosures (§ 226.33(b))

#### Disclosure Forms

#### Forms for Closed-End Credit

- a. Determine that the disclosures are clear, conspicuous, grouped, and segregated. The terms "finance charge" and "APR" should be more conspicuous than other terms. (§ 226.17(a))



- b. Determine that the disclosures include the following, as applicable: (§ 226.18)
- (1) Identity of the creditor
  - (2) Brief description of the finance charge
  - (3) Brief description of the APR
  - (4) Variable-rate verbiage (§ 226.18(f)(1) or 226.18(f)(2))
  - (5) Payment schedule
  - (6) Brief description of the total of payments
  - (7) Demand feature
  - (8) For a credit sale, description of total sales price
  - (9) Prepayment penalties or rebates
  - (10) Late-payment amount or percentage
  - (11) Description of security interest
  - (12) Various insurance verbiage (§ 226.4(d))
  - (13) Statement referring to the contract
  - (14) Statement regarding assumption of the note
  - (15) Statement regarding required deposits
- c. Determine whether all variable-rate loans with a maturity of more than 1 year secured by a principal dwelling are given the following disclosures at the time of application: (§ 226.19)
- (1) Consumer handbook on adjustable-rate mortgages, or a substitute
  - (2) Statement that interest rate payments and terms can change
  - (3) The index or formula and a source of information
  - (4) Explanation of the interest rate, payment determination, and margin
  - (5) Statement that the consumer should ask for the current interest rate and margin
  - (6) Statement that the interest rate is discounted, if applicable
  - (7) Frequency of interest rate and payment changes
  - (8) Rules relating to all changes
  - (9) Either (1) a historical example, based on a \$10,000 loan amount, illustrating how payments and the loan balance would have been affected by interest rate changes implemented according to the terms of the loan program over the past 15 years or (2) the initial and maximum interest rates and payments for a \$10,000 loan, along with a statement that the periodic payment may substantially increase or decrease and a statement of a maximum interest rate and payment
- (10) Explanation of how to compute the loan payment, and an example
- (11) Demand feature, if applicable
- (12) Statement regarding the content and timing of adjustment notices
- (13) Statement that other variable-rate loan program disclosures are available, if applicable
- d. Determine that the disclosures required for high-cost mortgage transactions clearly and conspicuously include the following items: (§ 226.32(c); see form H-16 in appendix H to Regulation Z)
- (1) The required statement “You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application. If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan.”
  - (2) Annual percentage rate
  - (3) Amount of the regular monthly (or other periodic) payment and amount of any balloon payment. The regular payment should include amounts for voluntary items, such as credit life insurance or debt-cancellation coverage, only if the consumer has previously agreed to the amount. (See staff commentary to § 226.32(c)(3).)
  - (4) For variable-rate loans, a statement that the interest rate may increase, and the amount of the single maximum monthly payment, based on the maximum interest rate allowed under the contract, if applicable
  - (5) For mortgage refinancings, the total amount borrowed, as reflected by the face amount of the note; and if the amount borrowed includes premiums or other charges for optional credit insurance or debt-cancellation coverage, a statement to that effect (grouped together with the amount borrowed)

### Forms for Open-End Credit

- a. Determine that the initial disclosure statement is provided before the first transaction under the account and includes the following items, as applicable: (§ 226.6)

- (1) Statement of when a finance charge would accrue and whether a grace period exists
  - (2) Statement of the periodic rates and the corresponding APR
  - (3) Explanation of the method of determining the balance on which the finance charge may be computed
  - (4) Explanation of how the finance charge would be determined
  - (5) Statement of the amount of any other charges
  - (6) Statement of the creditor's security interest in the property
  - (7) Statement of billing rights (§§ 226.12 and 226.13)
  - (8) Certain home equity plan information, if not provided with the application, in a form the consumer can keep (§ 226.6(e)(7))
- b. Determine that the following credit card disclosures were made clearly and conspicuously on or with a solicitation or an application. Disclosures in 12-point type are deemed to comply with the requirements. See commentary to section 226.5a(a)(2)-1. The APR for purchases (other than an introductory rate that is lower than the rate that will apply after the introductory rate expires) must be in at least 18-point type. (§ 226.5a)
- (1) APR for purchases, cash advances, and balance transfers, including penalty rates that may apply. If the rate is variable, the index or formula and the margin must be identified.
  - (2) Fee for issuance of the card
  - (3) Minimum finance charge
  - (4) Transaction fees
  - (5) Length of the grace period
  - (6) Balance-computation method
  - (7) Statement that charges incurred by using the charge card are due when the periodic statement is received
- Note: Items 1–7 must be provided in a prominent location in the form of a table. The following items (8–10) may be included in the same table or clearly and conspicuously elsewhere in the same document. An explanation of specific events that may result in the imposition of a penalty rate must be placed outside the table, with an asterisk inside the table (or other means) directing the consumer to the additional information.
- (8) Cash-advance fees
  - (9) Late-payment fees
  - (10) Fees for exceeding the credit limit
- c. Determine that the disclosure of items 1–7 in “b,” above, are made orally for creditor-initiated telephone applications and pre-approved solicitations. Also, determine for applications or solicitations made to the general public that the card issuer makes one of the optional disclosures. (§§ 226.5a(d) and 226.5a(e))
- d. Determine that the following home equity information was provided clearly and conspicuously at the time of application: (§ 226.5b)
- (1) Home equity brochure
  - (2) Statement that the consumer should retain a copy of the disclosure
  - (3) Statement of the time the specific terms are available
  - (4) Statement that terms are subject to change before the plan opens
  - (5) Statement that the consumer may receive a full refund of all fees
  - (6) Statement that the consumer's dwelling secures the credit
  - (7) Statement that the consumer could lose the dwelling
  - (8) Statement of the creditor's right to change, freeze, or terminate the account
  - (9) Statement that information about conditions for adverse action is available upon request
  - (10) Statement of payment terms, including the length of the draw and repayment periods, how the minimum payment is determined, the timing of payments, and an example based on \$10,000 and a recent APR
  - (11) A recent APR imposed under the plan and a statement that the rate does not include costs other than interest (fixed-rate plans only)
  - (12) Itemization of all fees to be paid to the creditor
  - (13) Estimate of any fees payable to third parties to open the account and a statement that the consumer may receive a good-faith itemization of third-party fees
  - (14) Statement regarding negative amortization, as applicable
  - (15) Statement of transaction requirements

- (16) Statement that the consumer should consult a tax advisor regarding the deductibility of interest and charges under the plan
- (17) For variable-rate home equity plans, disclosures including
  - i. That the APR, payment, or term may change
  - ii. That the APR excludes costs other than interest
  - iii. The index and its source
  - iv. How the rate will be determined
  - v. That the consumer should request information on the current index value, margin, discount, premium, or APR
  - vi. That the initial rate is discounted, and the duration of the discount, if applicable
  - vii. Frequency of APR changes
  - viii. Rules relating to changes in the index, APR, and payment amount
  - ix. Lifetime rate cap and any annual caps, or that there is no annual limitation
  - x. The minimum payment requirement, using the maximum APR, and when the maximum APR may be imposed
  - xi. A table, based on a \$10,000 balance, reflecting all significant plan terms
  - xii. That rate information will be provided on or with each periodic statement
- e. Determine when the last statement of billing rights was furnished to customers and whether the institution used the short-form notice with each periodic statement. (§ 226.9(a))
- f. Determine that the notice of any change in terms was provided 15 days prior to the effective date of the change. (§ 226.9(b))
- g. Determine that items 1–7 in “b,” above, are disclosed when the account is renewed. This disclosure must also state how and when the cardholder may terminate the credit to avoid paying the renewal fee. (§ 226.9(e))
- h. Determine that a statement regarding the maximum interest rate that may be imposed during the term of the obligation is made for any loan for which the APR may increase during the plan. (§ 226.30(b))

## Forms for Reverse Mortgages (Both Open- and Closed-End)

- a. Determine that the disclosures required for reverse mortgage transactions are substantially similar to the model form in appendix K to Regulation Z and include the following items:
  - (1) A statement that the consumer is not obligated to complete the reverse mortgage transaction merely because he or she has received the disclosures or signed an application
  - (2) A good-faith projection of the total cost of the credit expressed as a table of “total annual loan cost rates,” including payments to the consumer, additional creditor compensation, limitations on consumer liability, assumed annual appreciation, and the assumed loan period
  - (3) An itemization of loan terms, charges, the age of the youngest borrower, and the appraised property value
  - (4) An explanation of the table of total annual loan cost rates

Note: Forms that include or involve current transactions, such as change-in-terms notices, periodic billing statements, rescission notices, and billing-error communications, should be verified for accuracy when the file review worksheets are completed.

## Timing of Disclosures

- 5. Review financial institution policies, procedures, and systems to determine, either separately or when completing the actual file review, whether the applicable disclosures listed below are furnished when required by Regulation Z. Take into account products that have different features, such as closed-end loans or credit card accounts that are fixed or variable rate.
  - a. Credit card application and solicitation disclosures—On or with the application (§ 226.5a(b))
  - b. HELC disclosures—At the time the application is provided or within 3 business days under certain circumstances (§ 226.5b(b))
  - c. Open-end credit initial disclosures—Before the first transaction is made under the plan (§ 226.5(b)(1))
  - d. Periodic disclosures—At the end of a billing cycle if the account has a debit or credit balance of \$1 or more or if a finance charge has been imposed (§ 226.5(b)(2))

- e. Statement of billing rights—At least once a year (§ 226.9(a))
- f. Supplemental credit devices—Before the first transaction under the plan (§ 226.9(b))
- g. Open-end credit change in terms—15 days prior to the effective change date (§ 226.9(c))
- h. Finance charge imposed at time of transaction—Prior to imposing any fee (§ 226.9(d))
- i. Disclosures upon renewal of credit or charge card—30 days or 1 billing cycle, whichever is less, before the delivery of the periodic statement on which the renewal fee is charged. Alternatively, notice may be delayed until the mailing or delivery of the periodic statement on which the renewal fee is charged to the accounts if the notice meets certain requirements. (§ 226.9(e))
- j. Change in credit account insurance provider—Certain information 30 days before the change in provider occurs, and certain information 30 days after the change in provider occurs. The institution may provide a combined disclosure 30 days before the change in provider occurs. (§ 226.9(f))
- k. Closed-end credit disclosures—Before consummation (§ 226.17(b))
- l. Disclosures for certain closed-end home mortgages—3 business days prior to consummation (§ 226.31(c)(1))
- m. Disclosures for reverse mortgages—3 days prior to consummation of a closed-end credit transaction or prior to the first transaction under an open-end credit plan (§ 226.31(c)(2))
- n. Disclosures for adjustable-rate mortgages—At least once each year during which an interest rate adjustment is implemented without an accompanying payment change, and at least 25, but no more than 120, calendar days before a new payment amount is due, or in accordance with other variable-rate subsequent-disclosure regulations issued by a supervisory agency (§ 226.20(c))

## Electronic Disclosures

Note: Disclosures may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 USC 7001 et seq.). The E-Sign Act does not mandate that institutions or consumers use or accept electronic records or signatures. It permits institu-

tions to satisfy any statutory or regulatory requirements by providing the information electronically after obtaining the consumer's affirmative consent. Before consent can be given, consumers must be provided with the following information:

- Any right or option to have the information provided in paper or non-electronic form;
- The right to withdraw the consent to receive information electronically and the consequences, including fees, of doing so;
- The scope of the consent (for example, whether the consent applies only to a particular transaction or to identified categories of records that may be provided during the course of the parties' relationship);
- The procedures to withdraw consent and to update information needed to contact the consumer electronically; and
- The methods by which a consumer may obtain, upon request, a paper copy of an electronic record after consent has been given to receive the information electronically and whether any fee will be charged.

The consumer must consent electronically or confirm consent electronically in a manner that "reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent." After the consent, if an institution changes the hardware or software requirements such that a consumer may be prevented from accessing and retaining information electronically, the institution must notify the consumer of the new requirements and must allow the consumer to withdraw consent without charge.

6. If the financial institution makes its disclosures available to consumers in electronic form, determine that the forms comply with the appropriate sections—226.5(a)(1); 226.5a(a)(2)(v); 226.5b(a)(3); 226.15(b); 226.16(c); 226.17(a)(1); 226.17(g); 226.19(c); 226.23(b)(1); 226.24(d); and 226.31(b).

## Record Retention

7. Review the financial institution's record-retention practices to determine whether evidence of compliance (for other than the advertising requirements) is retained for at least 2 years after the disclosure was required to be made or other action was required to be taken. (§ 226.25)

## Transaction Testing

Note: When verifying APR accuracies, use the OCC's APR calculation model or other acceptable calculation tool.

### Advertising

8. Sample advertising copy, including any Internet advertising, since the previous examination and verify that the terms of credit are specific. If triggering terms are used, determine that the required disclosures are made. (§§ 226.16 and 226.24)

For advertisements for closed-end credit, determine,

- If a rate of finance charge was stated, that it was stated as an APR
- If an APR will increase after consummation, that a statement to that effect is made

### Closed-End Credit

9. For each type of closed-end loan being tested, determine the accuracy of the disclosures by comparing the disclosures with the contract and other financial institution documents. (§ 226.17)
10. Determine whether the required disclosures were made before consummation of the transaction, and ensure the presence and accuracy of the items below, as applicable. (§ 226.18)
  - a. Amount financed
  - b. Itemization of the amount financed (RESPA good-faith estimate may be substituted)
  - c. Finance charge
  - d. APR
  - e. Variable-rate verbiage, as follows, for loans not secured by a principal dwelling or loans with terms of 1 year or less:
    - (1) Circumstances that permit a rate increase
    - (2) Limitations on the increase (periodic or lifetime)
    - (3) Effects of the increase
    - (4) Hypothetical example of new payment terms
  - f. Payment schedule, including amount, timing, and number of payments
  - g. Total of payments
  - h. Total sales price (credit sale)
  - i. Description of security interest
  - j. Credit life insurance premium is included in the finance charge, unless all three of the

following conditions are met:

- (1) Insurance is not required
  - (2) Premium for the initial term is disclosed
  - (3) Consumer signs or initials an affirmative written request for the insurance
- k. Property insurance available from the creditor is excluded from the finance charge if the premium for the initial term of the insurance is disclosed
  - l. Required deposit
11. Determine, for adjustable-rate mortgage loans that are secured by the borrower's principal dwelling and have maturities of more than 1 year, that the required early and subsequent disclosures are complete, accurate, and timely. Early disclosures required by section 226.19(a) are verified during the closed-end credit forms review. Subsequent disclosures should include the items below, as applicable: (§ 226.20(c))
    - a. Current and prior interest rates
    - b. Index values used to determine current and prior interest rates
    - c. Extent to which the creditor has foregone an increase in the interest rate
    - d. Contractual effects of the adjustment (new payment and loan balance)
    - e. Payment required to avoid negative amortization
 

Note: The accuracy of the adjusted interest rates and indexes should be verified by comparing them with the contract and with early disclosures. Refer to the "Additional Variable-Rate Testing" section of these examination procedures.
  12. Determine, for each type of closed-end rescindable loan being tested, whether 2 copies of the rescission notice are provided to each person whose ownership interest is or will be subject to the security interest. The rescission notice must disclose the following items: (§ 226.23(b))
    - a. Security interest taken in the consumer's principal dwelling
    - b. Consumer's right to rescind the transaction
    - c. How to exercise the right to rescind, with a form for that purpose, stating the address of the creditor's place of business
    - d. Effects of rescission
    - e. Date the rescission period expires
  13. Ensure that funding was delayed until the rescission period expired. (§ 226.23(c))
  14. Determine if the institution has received any requests to waive the 3-day right to rescind since the previous examination. If applicable, test rescission waivers. (§ 226.23(e))

15. Determine whether the maximum interest rate in the contract is disclosed for any adjustable-rate consumer credit contract secured by a dwelling. (§ 226.30(a))

### Open-End Credit

16. For each open-end credit product tested, determine the accuracy of the disclosures by comparing the disclosures with the contracts and other financial institution documents. (§ 226.5(c))
17. Review the financial institution's policies, procedures, and practices to determine whether it provides appropriate disclosures for creditor-initiated direct mail applications and solicitations to open charge card accounts, telephone applications and solicitations to open charge card accounts, and applications and solicitations made available to the general public to open charge card accounts. (§§ 226.5a(b)-(d))
18. Determine, for all home equity plans with a variable rate, that the APR is based on an independent index. Further, ensure that home equity plans are terminated or terms are changed only if certain conditions exist. (§ 226.5b(f))
19. Determine that if any consumer rejected a home equity plan because a disclosed term changed before the plan was opened, all fees were refunded. Verify that nonrefundable fees were not imposed until 3 business days after the consumer received the required disclosures and brochure. (§§ 226.5b(g) and 226.5b(h))
20. Review consecutive periodic billing statements for each major type of open-end credit activity offered (overdraft and home equity lines of credit, credit card programs, and so forth). Determine whether disclosures were calculated accurately and are consistent with the initial disclosure statement furnished in connection with the accounts (or any subsequent change-in-terms notice) and the underlying contractual terms governing the plan(s). The periodic statement must disclose the following items, as applicable: (§ 226.7)
  - a. Previous balance
  - b. Identification of transactions
  - c. Dates and amounts of any credits
  - d. Periodic rates and corresponding APRs; for variable-rate plans, that the periodic rates may vary
  - e. Balance on which the finance charge is computed, and an explanation of how the balance is determined

- f. Amount of the finance charge, with an itemization of each of the components of the finance charge
- g. Annual percentage rate
- h. Itemization of other charges
- i. Closing date and balance
- j. Payment date, if there is a "free ride" period
- k. Address for notice of billing errors
21. Verify that the institution credits a payment to an open-end account as of the date of receipt. (§ 226.10)
22. Determine how the institution handles credit balances. Specifically, if an account's credit balance is in excess of \$1, the institution must take the following actions: (§ 226.11)
  - a. Credit the amount to the consumer's account
  - b. Refund any part of the remaining credit balance within 7 business days from receiving a written request from the consumer
  - c. Make a good-faith effort to refund the amount of the credit to a deposit account of the consumer if the credit remains for more than 6 months
23. Review samples of billing-error-resolution files and correspondence from consumers asserting a claim or defense against the financial institution for a credit card dispute regarding property or services. Verify the following: (§§ 226.12 and 226.13)
  - a. Credit cards are issued only upon request
  - b. Liability for unauthorized credit card use is limited to \$50
  - c. Disputed amounts are not reported as delinquent unless remaining unpaid after the dispute has been settled
  - d. Offsetting credit card indebtedness is prohibited
  - e. Errors are resolved within two complete billing cycles
24. Determine, for each type of open-end rescindable loan being tested, that two copies of the rescission notice are provided to each person whose ownership interest is or will be subject to the security interest and follow procedures 11, 12, and 13 in the section "Closed-End Credit."

### Additional Variable-Rate Testing

25. Verify that when accounts were opened or loans were consummated, the loan contract terms were recorded correctly in the financial institution's calculation systems (for example, its computer). Determine the accuracy of the

following recorded information:

- a. Index value
  - b. Margin and method of calculating rate changes
  - c. Rounding method
  - d. Adjustment caps (periodic and lifetime)
26. Using a sample of periodic disclosures for open-end variable-rate accounts (for example, home equity accounts) and closed-end rate-change notices for adjustable-rate mortgage loans,
- a. Compare the rate-change date and rate on the credit obligation with the actual rate-change date and rate imposed.
  - b. Determine that the index disclosed and imposed is based on the terms of the contract. (Example: The weekly average of 1-year Treasury constant maturities, as of 45 days before the change date.) (§§ 226.7(g) and 226.20(c)(2))
  - c. Determine that the new interest rate is correctly disclosed by adding the correct index value with the margin stated in the note, plus or minus any contractual fractional adjustment. (§§ 226.7(g) and 226.20(c)(1))
  - d. Determine that the new payment disclosed (section 226.20(c)(4)) was based on an interest rate and loan balance in effect at least 25 days before the payment change date (consistent with the contract). (§ 226.20(c))
- mortgage transaction covered by section 226.32 or a closed-end reverse mortgage transaction (or at least 3 business days prior to the first transaction under an open-end reverse mortgage) (§ 226.31(c))
- d. Disclosures reflect the terms of the legal obligation between the parties (§ 226.31(d))
  - e. The institution abides by the disclosure rules for multiple consumers and multiple creditors. If the obligation involves multiple consumers, the disclosures may be provided to any consumer who is primarily liable on the obligation. However, for rescindable transactions, the disclosures must be provided to each consumer who has the right to rescind. If the transaction involves more than one creditor, only one creditor should provide the disclosures. (§ 226.31(e))
  - f. The APR is accurately calculated and disclosed in accordance with the requirements and within the tolerances allowed in section 226.22 (§ 226.31(g))
30. For high-cost mortgages (section 226.32), ensure that
- a. In addition to other required disclosures, the creditor gives the following at least 3 business days prior to consummation (see the model disclosure in appendix H-16):
    - (1) Notice containing the prescribed language (§ 226.32(c)(1))
    - (2) Annual percentage rate (§ 226.32(c)(2))
    - (3) Amount of regular loan payment and amount of any balloon payment (§ 226.32(c)(3))
    - (4) For variable-rate loans, a statement that the interest rate and monthly payment may increase, and the amount of the single maximum monthly payment allowed under the contract (§ 226.32(c)(4))
    - (5) For mortgage refinancings, the total amount the consumer will borrow (the face amount), and if this amount includes premiums or other charges for optional credit insurance or debt-cancellation coverage, that fact. This disclosure is to be treated as accurate if the disclosed face amount is within \$100 of the actual amount. (§ 226.32(c)(5))
    - (6) A new disclosure is required if subsequent to providing the additional disclosure but prior to consummation, there are changes in any terms that make the disclosures inaccurate. For

### Certain Home Mortgage Transactions

27. Determine whether the financial institution originates consumer credit transactions subject to subpart E of Regulation Z, specifically, certain closed-end home mortgages (high-cost mortgages (section 226.32) and reverse mortgages (section 226.33)).
28. Examiners may use the worksheet at the end of these examination procedures as an aid in identifying and reviewing high-cost mortgages.
29. Review both high-cost and reverse mortgages to ensure that
  - a. Required disclosures are provided to consumers in addition to, not in lieu of, the disclosures contained in other subparts of Regulation Z (§ 226.31(a))
  - b. Disclosures are clear and conspicuous, in writing, and in a form that the consumer can keep (§ 226.31(b))
  - c. Disclosures are furnished at least 3 business days prior to consummation of a

example, if a consumer purchases optional credit insurance and, as a result, the monthly payment differs from the payment previously disclosed, redisclosure is required and a new 3-day waiting period applies. (§ 226.31(c)(1)(i))

- (7) If a creditor provides new disclosures by telephone when the consumer initiates a change in terms, then at consummation (§ 226.31(c)(1)(ii))
  - The creditor must provide new written disclosures and both parties must sign a statement that these new disclosures were provided by telephone at least 3 days prior to consummation.
- (8) If a consumer waives the right to a 3-day waiting period to meet a bona fide personal financial emergency, the consumer's waiver must be a dated written statement (not a preprinted form) describing the emergency and bearing the signature of all entitled to the waiting period (a consumer may waive *only after* receiving the required disclosures and prior to consummation). (§ 26.31(c)(1)(iii))

b. High-cost mortgage transactions do not include any of the following terms:

- (1) Balloon payment (if the term is less than 5 years, with exceptions) (§§ 226.32(d)(1)(i) and 226.32(d)(1)(ii))
- (2) Negative amortization (§ 226.32(d)(2))
- (3) Advance payments from the proceeds of more than two periodic payments (§ 226.32(d)(3))
- (4) Increased interest rate after default (§ 226.32(d)(4))
- (5) A rebate of interest, arising from a loan acceleration due to default, that is calculated by a method less favorable than the actuarial method (§ 226.32(d)(5))
- (6) Prepayment penalties (but permitted in the first 5 years if certain conditions are met) (§§ 226.32(d)(6) and 226.32(d)(7))
- (7) A due-on-demand clause permitting the creditor to terminate the loan in advance of maturity and accelerate the balance, with certain exceptions (§ 226.32(d)(8))

c. The creditor is not engaged in the following acts and practices for high-cost mortgages:

- (1) *Home improvement contracts*—Paying

a contractor under a home improvement contract from the proceeds of a mortgage unless certain conditions are met (§ 226.34(a)(1))

- (2) *Notice to assignee*—Selling or otherwise assigning a high-cost mortgage without furnishing the required statement to the purchaser or assignee (§ 226.34(a)(2))
- (3) *Refinancing within 1 year of extending credit*—Within 1 year of making a high-cost mortgage loan, a creditor may not refinance any high-cost mortgage loan to the same borrower into another high-cost mortgage loan that is not in the borrower's interest. This restriction also applies to assignees that hold or service the high-cost mortgage loan. Commentary to section 226.34(a)(3) has examples that apply the refinancing prohibition and address "borrower's interest."
- (4) *Consumer's ability to repay*—Engaging in a pattern or practice of extending high-cost mortgages based on the consumer's collateral without regard to repayment ability, including the consumer's current and expected income, current obligations, and employment. A violation is presumed if there is a pattern or practice of making such mortgage loans without verifying and documenting the consumer's repayment ability.
  - A. A creditor may consider any expected income of the consumer, including
    - i. Regular salary or wages
    - ii. Gifts
    - iii. Expected retirement payments
    - iv. Income from self-employment
  - B. Equity income that would be realized from the collateral may not be considered.
  - C. Creditors may verify and document a consumer's income and obligations through any reliable source that provides the creditor with a reasonable basis for believing that there are sufficient funds to support the loan. Reliable sources include
    - i. Credit reports
    - ii. Tax return
    - iii. Pension statements
    - iv. Payment records for employ-



ment income

- D. If a loan transaction includes a discounted introductory rate, the creditor must consider the consumer's ability to repay on the basis of the nondiscounted or fully indexed rate.

Note: Commentary to section 226.34(a)(4) contains guidance on income that may be considered, on "pattern or practice," and on "verifying and documenting" income and obligations.

31. Ensure that the creditor does not structure a home-secured loan as an open-end plan ("spurious open-end credit") to evade the requirements of Regulation Z. See staff commentary to section 226.34(b) for factors to be considered.

TILA, for avoiding civil liability and of its option under the policy guide and section 108(e)(6) of the TILA for avoiding a regulatory agency's order to reimburse affected borrowers.

## Administrative Enforcement

32. If there is noncompliance involving understated finance charges or understated APRs subject to reimbursement under the FFIEC Policy Guide on Reimbursement, continue with procedure 32.
33. Document the date on which the administrative enforcement of the TILA policy statement would apply for reimbursement purposes by determining the date of the preceding examination.
34. If the noncompliance involves indirect (third-party paper) disclosure errors and affected consumers have not been reimbursed,
- Prepare comments, discussing the need for improved internal controls, to be included in the report of examination.
  - Notify your supervisory office for follow up with the regulator that has primary responsibility for the original creditor.

If the noncompliance involves direct credit,

- Make an initial determination as to whether the violation is a pattern or practice.
- Calculate the reimbursement for the loans or accounts in an expanded sample of the identified population.
- Estimate the total impact on the population based on the expanded sample.
- Inform management that reimbursement may be necessary under the law and the FFIEC policy guide, and discuss all substantive facts, including the sample loans and calculations.
- Inform management of the financial institution's options, under section 130 of the

## HIGH-COST-MORTGAGE (§ 226.32) WORKSHEET

Borrower's name \_\_\_\_\_ Loan number \_\_\_\_\_

### COVERAGE

Yes No

Is the loan secured by the consumer's principal dwelling? (§§ 226.2(a)(19) and 226.32(a)(1))		
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If the answer is No, STOP HERE

Is the loan for the following purpose?

1 Residential mortgage transaction (§ 226.2(a)(24))		
2 Reverse mortgage transaction (§ 226.33)		
3 Open-end credit plan (Subpart B) (Note prohibition against structuring loans as open-end plans to evade sections 226.32–226.34(b))		

If the answer is Yes in Box 1, 2, or 3, STOP HERE. If No, continue to Test 1.

### TEST 1: CALCULATION OF APR

A Disclosed APR	
B Treasury security yield of comparable maturity Obtain the Treasury constant maturities yield from the Board's H.15 statistical release, "Selected Interest Rates" (on the Board's web site ( <a href="http://www.federalreserve.gov/releases/h15/data.htm">www.federalreserve.gov/releases/h15/data.htm</a> ), the "Business" links display daily yields). Use the yield that has the maturity most comparable to the loan term and is from the 15th day of the month that immediately precedes the month of the application. If the 15th is not a business day, use the yield for the business day immediately preceding the 15th. If the loan term is exactly halfway between two published security maturities, use the lower of the two yields. Note: Creditors may use the interest rates in the H.15 release or the actual auction results. See staff commentary to Regulation Z for further details. (§ 226.32(a)(1)(i))	
C Treasury security yield of comparable maturity (from Box B) <i>Plus:</i> 8 percentage points for first-lien loan <i>or</i> 10 percentage points for subordinate-lien loan	

Yes No

D Is Box A greater than Box C?		
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If Yes, the transaction is a high-cost mortgage. If No, continue to Test 2.

## HIGH-COST MORTGAGE (§ 226.32) WORKSHEET—continued

### TEST 2: CALCULATION OF POINTS AND FEES

#### STEP 1: Identify all charges paid by the consumer at or before loan closing

<p>A Finance charges (§§ 226.4(a) and (b)) (Interest, including per-diem interest, and time-price differential are excluded from these amounts.)</p>	
	Fee
Loan points	<input type="text"/>
Mortgage broker fee	<input type="text"/>
Loan service fees	<input type="text"/>
Required closing agent/third-party fees	<input type="text"/>
Required credit insurance	<input type="text"/>
Private mortgage insurance	<input type="text"/>
Life-of-loan charges (flood, taxes, etc.)	<input type="text"/>
Any other fees considered finance charges	<input type="text"/>
	Subtotal
<p>B Certain non-finance charges under section 226.4(c)(7) Include fees paid by consumers <i>only</i> if the amount of the fee is unreasonable, the creditor receives direct or indirect compensation from the charge, or the charge is paid to an affiliate of the bank. (See the example in section 226.32(b)(1)(ii) of the commentary for further explanation.)</p>	
	Fee
Title examination	<input type="text"/>
Title insurance	<input type="text"/>
Property survey	<input type="text"/>
Document preparation charge	<input type="text"/>
Credit report	<input type="text"/>
Appraisal	<input type="text"/>
Fee for "initial" flood hazard determination	<input type="text"/>
Pest inspection	<input type="text"/>
Any other fees not considered finance charges	<input type="text"/>
	Subtotal
<p>C Premiums or other charges for optional credit life, accident, health, or loss-of-income insurance or debt-cancellation coverage</p>	
	Subtotal
<p>D Total points and fees: Add subtotals for Boxes A, B, and C</p>	

## HIGH-COST MORTGAGE (§ 226.32) WORKSHEET—continued

### TEST 2—continued

#### STEP 2: Determine the total loan amount for cost calculation (§ 226.32(a)(1)(ii))

A Determine the amount financed (§ 226.18(b)) Principal loan amount	
<i>Plus:</i> Other amounts financed by the lender ( <i>not already included in the principal and not part of the finance charge</i> )	
<i>Less:</i> Prepaid finance charges (§ 226.2(a)(23))	
<i>EQUALS:</i> Amount financed	
B Deduct costs included in the points and fees under sections 226.32(b)(1)(iii) and (iv) (Step 1, Box B and Box C) that are financed by the creditor	
C Total loan amount (Step 2, Box A minus Box B)	

#### STEP 3: Perform high-fee cost calculation

A 8 percent of the total loan amount (from Step 2, Box C)	
B Annual adjustment amount (§ 226.32(a)(1)(ii)) 1999 \$441      2003 \$488 2000 \$451      2004 \$499 2001 \$465      2005 \$510 2002 \$480      2006 \$528 <i>(Use the dollar amount corresponding to the year of the loan's origination.)</i>	
C Total points and fees (from Step 1, Box D)	

Yes      No

In Step 3, does Box C exceed the greater of Box A or Box B?		
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If Yes, the transaction is a high-cost mortgage. If No, the transaction is not a high-cost mortgage under Test 2.



# Fair Debt Collection Practices Act

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## Background

The Fair Debt Collection Practices Act (FDCPA) (15 USC 1692 et seq.), which became effective in March 1978, was designed to eliminate abusive, deceptive, and unfair debt collection practices. It also protects reputable debt collectors from unfair competition and encourages consistent state action to protect consumers from abuses in debt collection.

## Coverage

### Debt That Is Covered

The FDCPA applies only to the collection of debt incurred by a consumer primarily for personal, family, or household purposes. It does not apply to the collection of corporate debt or debt owed for business or agricultural purposes.

### Debt Collectors That Are Covered

The FDCPA defines a *debt collector* as any person who regularly collects, or attempts to collect, consumer debts for another person or institution or uses some name other than its own when collecting its own consumer debts. The definition includes, for example, an institution that regularly collects debts for an unrelated institution, such as an institution that, under a reciprocal service arrangement, solicits the help of another in collecting a defaulted debt from a customer who has moved.

### Debt Collectors That Are Not Covered

An institution is not considered a debt collector under the FDCPA when it collects

- Another institution's debts in isolated instances
- Its own debts under its own name
- Debts it originated and then sold but continues to service (for example, mortgage and student loans)
- Debts that were not in default when they were obtained
- Debts that were obtained as security for a commercial credit transaction (for example, accounts receivable financing)
- Debts incidental to a bona fide fiduciary relationship or escrow arrangement (for example, a debt held in the institution's trust department or mortgage loan escrow for taxes and insurance)

- Debts, regularly, for other institutions to which it is related by common ownership or corporate control

Other debt collectors that are not covered by the FDCPA include

- Officers or employees of an institution who collect debts owed to the institution in the institution's name
- Legal-process servers

## Communications in Connection with Debt Collection

### Definition of *Consumer*

For communications with a consumer or third party in connection with the collection of a debt, the term *consumer* is defined to include the borrower's spouse, parent (if the borrower is a minor), guardian, executor, or administrator.

### When, Where, and with Whom Communication Is Permitted

#### *Communicating with Consumers*

A debt collector may not communicate with a consumer at any unusual time (generally before 8:00 a.m. or after 9:00 p.m. in the consumer's time zone) or at any place that is inconvenient to the consumer, unless the consumer or a court of competent jurisdiction has given permission for such contacts. A debt collector may not contact the consumer at his or her place of employment if the collector has reason to believe the employer prohibits such communications.

If the debt collector knows that the consumer has retained an attorney to handle the debt and can easily ascertain the attorney's name and address, all contacts must be with that attorney, unless the attorney is unresponsive or agrees to allow direct communication with the consumer.

#### *Ceasing Communication with Consumers*

When a consumer refuses, in writing, to pay a debt or requests that the debt collector cease further communication, the collector must cease all further communication, except to advise the consumer that

- The collection effort is being stopped

- Certain specified remedies ordinarily invoked may be pursued or, if appropriate, that a specific remedy will be pursued
- Mailed notices from the consumer are official when they are received by the debt collector

### *Communicating with Third Parties*

The only third parties that a debt collector may contact when trying to collect a debt are

- The consumer
- The consumer's attorney
- A consumer reporting agency (if permitted by local law)
- The creditor
- The creditor's attorney
- The debt collector's attorney

The consumer or a court of competent jurisdiction may, however, give the debt collector specific permission to contact other third parties. In addition, a debt collector who is unable to locate a consumer may ask a third party for the consumer's home address, telephone number, and place of employment (location information). The debt collector must give his or her name and must state that he or she is confirming or correcting information about the consumer's location. Unless specifically asked, the debt collector may not name the collection firm or agency or reveal that the consumer owes any debt.

No third party may be contacted more than once unless the collector believes that the information from the first contact was wrong or incomplete and that the third party has since received better information, or unless the third party specifically requests additional contact.

Contact with any third party by postcard, letter, or telegram is allowed only if the envelope or content of the communication does not indicate the nature of the collector's business.

### **Validation of Debts**

A debt collector must provide the consumer with certain basic information. If that information was not in the initial communication and if the consumer has not paid the debt five days after the initial communication, all of the following information must be sent to the consumer in written form:

- The amount of the debt
- The name of the creditor to whom the debt is owed
- Notice that the consumer has thirty days to dispute the debt before it is assumed to be valid

- Notice that upon such written dispute, the debt collector will send the consumer a verification of the debt or a copy of any judgment
- If the original creditor is different from the current creditor, notice that if the consumer makes a written request for the name and address of the original creditor within the thirty-day period, the debt collector will provide that information

If, within the thirty-day period, the consumer disputes in writing any portion of the debt or requests the name and address of the original creditor, the collector must stop all collection efforts until he or she mails the consumer a copy of a judgment or verification of the debt, or the name and address of the original creditor, as applicable.

### **Prohibited Practices**

#### **Harassing or Abusive Practices**

A debt collector, in collecting a debt, may not harass, oppress, or abuse any person. Specifically, a debt collector may not

- Use or threaten to use violence or other criminal means to harm the physical person, reputation, or property of any person
- Use obscene, profane, or other language that abuses the hearer or reader
- Publish a list of consumers who allegedly refuse to pay debts, except to a consumer reporting agency or to persons meeting the requirements of section 603(f) or 604(3) of the FDCPA
- Advertise a debt for sale to coerce payment
- Annoy, abuse, or harass persons by repeatedly calling their telephone number or allowing their telephone to ring continually
- Make telephone calls without properly identifying himself or herself, except as allowed to obtain location information

#### **False or Misleading Representations**

A debt collector, in collecting a debt, may not use any false, deceptive, or misleading representation. Specifically, a debt collector may not

- Falsely represent or imply that he or she is vouched for, bonded by, or affiliated with the United States or any state, including the use of any badge, uniform, or similar identification
- Falsely represent the character, amount, or legal status of the debt, or of any services rendered, or compensation he or she may receive for collecting the debt
- Falsely represent or imply that he or she is an attorney or that communications are from an attorney

- Threaten to take any action that is not legal or intended
- Falsely represent or imply that nonpayment of any debt will result in the arrest or imprisonment of any person or the seizure, garnishment, attachment, or sale of any property or wages of any person, unless such action is lawful and intended by the debt collector or creditor
- Falsely represent or imply that the sale, referral, or other transfer of the debt will cause the consumer to lose a claim or a defense to payment, or become subject to any practice prohibited by the FDCPA
- Falsely represent or imply that the consumer committed a crime or other conduct to disgrace the consumer
- Communicate, or threaten to communicate, false credit information or information that should be known to be false, including not identifying disputed debts as such
- Use or distribute written communications made to look like or falsely represent documents authorized, issued, or approved by any court, official, or agency of the United States or any state if the appearance or wording would give a false impression of the document's source, authorization, or approval
- Use any false representation or deceptive means to collect or attempt to collect a debt or to obtain information about a consumer
- Fail to disclose in the initial written communication with the consumer, and the initial oral communication if it precedes the initial written communication, that the debt collector is attempting to collect a debt and that any information obtained will be used for that purpose. In addition, the debt collector must disclose in subsequent communications that the communication is from a debt collector. (These disclosures do not apply to a formal pleading made in connection with a legal action.)
- Falsely represent or imply that accounts have been sold to innocent purchasers for value
- Falsely represent or imply that documents are legal process
- Use any name other than the true name of the debt collector's business, company, or organization
- Falsely represent or imply that documents are not legal-process forms or do not require action by the consumer
- Falsely represent or imply that the debt collector operates or is employed by a consumer reporting agency

## Unfair Practices

A debt collector may not use unfair or unconscionable means to collect or attempt to collect a debt. Specifically, a debt collector may not

- Collect any interest, fee, charge, or expense incidental to the principal obligation unless it was authorized by the original debt agreement or is otherwise permitted by law
- Accept a check or other instrument postdated by more than five days, unless he or she notifies the consumer, in writing, of any intention to deposit the check or instrument; the notice must be made no more than ten nor less than three business days before the date of deposit
- Solicit a postdated check or other postdated payment instrument to use as a threat or to institute criminal prosecution
- Deposit or threaten to deposit a postdated check or other postdated payment instrument before the date on the check or instrument
- Cause communication charges, such as charges for collect telephone calls and telegrams, to be made to any person by concealing the true purpose of the communication
- Take or threaten to repossess or disable property when the creditor has no enforceable right to the property or does not intend to do so, or if, under law, the property may not be taken, repossessed, or disabled
- Use a postcard to contact a consumer about a debt

## Multiple Debts

If a consumer owes several debts that are being collected by the same debt collector, payments must be applied according to the consumer's instructions. No payment may be applied to a disputed debt.

## Legal Actions by Debt Collectors

A debt collector may file a lawsuit to enforce a security interest in real property only in the judicial district in which the real property is located. Other legal actions may be brought only in the judicial district in which the consumer lives or in which the original contract creating the debt was signed.

## Furnishing Certain Deceptive Forms

No one may design, compile, or furnish any form that creates the false impression that someone other than the creditor (for example, a debt collector) is participating in the collection of a debt.



## Civil Liability

A debt collector who fails to comply with any provision of the FDCPA is liable for

- Any actual damages sustained as a result of that failure
- Punitive damages as allowed by the court:
  - In an individual action, up to \$1,000
  - In a class action, up to \$1,000 for each named plaintiff and an award to be divided among all members of the class of an amount up to \$500,000 or 1 percent of the debt collector's net worth, whichever is less
- Costs and a reasonable attorney's fee in any such action

In determining punitive damages, the court must consider the nature, frequency, and persistency of the violations and the extent to which they were intentional. In a class action, the court must also consider the resources of the debt collector and the number of persons adversely affected.

## Defenses

A debt collector is not liable for a violation if a preponderance of the evidence shows that the violation was not intentional and was the result of a bona fide error that arose despite procedures reasonably designed to avoid any such error. The collector is also not liable if he or she, in good faith, relied on an advisory opinion of the Federal Trade Commission, even if the ruling is later amended, rescinded, or determined to be invalid for any reason.

## Jurisdiction and Statute of Limitations

Action against debt collectors for violations of the FDCPA may be brought in any appropriate U.S. district court or other court of competent jurisdiction. The consumer has one year from the date on which the violation occurred to start such an action.

## Administrative Enforcement

The Federal Trade Commission (FTC) is the primary enforcement agency for the FDCPA. The various financial regulatory agencies enforce the FDCPA for the institutions they supervise. Neither the FTC nor any other agency may issue regulations governing the collection of consumer debts by debt collectors. The FTC may, however, issue advisory opinions under the Federal Trade Commission Act on the meaning and application of the FDCPA.

## Relation to State Law

The FDCPA preempts state law only to the extent that a state law is inconsistent with the FDCPA. A state law that is more protective of the consumer is not considered inconsistent with the FDCPA.

## Exemption for State Regulation

The FTC may exempt certain classes of debt collection practices from the requirements of the FDCPA if the FTC has determined that state laws impose substantially similar requirements and that there is adequate provision for enforcement.

# Fair Debt Collection Practices Act Examination Objectives and Procedures

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## EXAMINATION OBJECTIVES

1. To determine the adequacy of the institution's internal procedures and controls to ensure consistent compliance with the FDCPA
2. To determine if the institution complies with the requirements of the FDCPA in collecting or attempting to collect third-party consumer debts

## EXAMINATION PROCEDURES

The following procedures are to be completed through interviews with personnel knowledgeable about and directly engaged in the institution's collection activities and through reviews of any written collection procedures, reciprocal collection agreements, collection letters, dunning notices, envelopes, scripts used by collection personnel, validation notices, individual collection files, complaint files, and other relevant records.

1. Determine if the institution is a debt collector under the FDCPA.

2. Determine if the institution has established internal procedures and controls to ensure compliance with the FDCPA.
3. If the institution has acted or is acting as a debt collector under the FDCPA, determine if the institution has
  - a. Communicated with the consumer or third parties in any prohibited manner
  - b. Furnished the written validation notice within the required time period and otherwise complied with applicable validation requirements
  - c. Used any harassing, abusive, unfair, or deceptive collection practice prohibited by the FDCPA
  - d. Collected any amount not expressly authorized by the agreement creating the debt or by state law
  - e. Applied all payments received as instructed and, where no instruction was given, applied payments only to undisputed debts
  - f. Filed suit in an authorized forum if the institution sued to collect the debt



# Fair Debt Collection Practices Act Examination Checklist

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1. Is the institution aware of the circumstances in which the FDCPA applies, and, as appropriate, has it established internal procedures and controls to ensure compliance with the FDCPA? Yes    No
  
  2. Has the institution acted as a “debt collector” under the FDCPA by either
    - a. Regularly attempting to collect defaulted consumer debts owed to others or Yes    No
    - b. Attempting to collect its own consumer debts in a name other than its own Yes    No
- If the answers to questions 2a and 2b are “no,” the institution has not acted as a debt collector under the FDCPA and the examiner should not complete the remainder of the checklist.
3. In attempting to collect consumer debts as a “debt collector” under the FDCPA, did the institution
    - a. Communicate with the consumer or any third party in a prohibited manner Yes    No
    - b. Adhere to the required debt-validation procedure Yes    No
    - c. Use any harassing, abusive, unfair, or deceptive practice or means Yes    No
    - d. Collect any more than authorized by the debt instrument or state law Yes    No
    - e. Properly apply any payment received in the case of multiple debts owed by the same consumer Yes    No
    - f. Bring legal action only in a judicial district permitted under the FDCPA Yes    No



# Homeowners Protection Act

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## Background

The Homeowners Protection Act of 1998 became effective in July 1999. The act, also known as the PMI Cancellation Act, addresses the difficulties homeowners have experienced in canceling private mortgage insurance (PMI) coverage. It establishes provisions for the cancellation and termination of PMI,<sup>1</sup> sets forth disclosure and notification requirements, and requires the return of unearned premiums.

Historically, lenders have viewed an 80 percent loan-to-value (LTV) ratio (and a corresponding 20 percent down payment) as a prudent standard for making consumer real estate loans. This ratio has served to ensure that the borrower had enough of an interest in the property to continue to make the payments and, in the event the borrower was unable to make the payments, that the lender had sufficient equity available to cover lender foreclosure costs.

As housing prices increased (and the corresponding down payment amounts increased), saving for a sufficient down payment became difficult for many prospective homeowners. To further the goal of making homeownership attainable for more Americans, lenders began to look for ways to balance the increasing demand for home loans with the risks inherent in providing loans that fell outside the 80 percent LTV standard. PMI, which is activated only if the borrower defaults on the loan, helps address a lender's risk by covering the difference between the amount a borrower has available to put down and the amount suggested by the standard 20 percent down payment rule. In effect, PMI helps mitigate a lender's risk on loans for which the down payment is less than 20 percent of the sales price or, for a refinancing, when the amount financed is greater than 80 percent of the appraised value.

PMI protects lenders from the risk of default and foreclosure. It allows prospective buyers who cannot, or choose not to, make a significant down payment to obtain mortgage financing at an affordable rate. It is used extensively to facilitate "high-ratio" loans (generally, loans for which the loan-to-value ratio exceeds 80 percent). With PMI, the lender is able to recover the costs associated

with the resale of foreclosed property as well as the accrued interest payments and the fixed costs, such as taxes and insurance policies, paid before the resale. Once the consumer's loan balance falls within the 80 percent LTV ratio, PMI is no longer needed. Excessive PMI coverage provides little extra protection for a lender and does not benefit the borrower.

Before implementation of the act, many homeowners experienced problems in canceling PMI. In some instances, lenders may have agreed to terminate coverage when the borrower's equity reached 20 percent, but the policies and procedures used for canceling or terminating PMI coverage varied widely among lenders. Homeowners had limited recourse when lenders refused to cancel their PMI coverage. Even homeowners in the few states that had laws pertaining to PMI cancellation or termination noted difficulties in canceling or terminating their PMI policies. The act protects homeowners by prohibiting life-of-loan PMI coverage for borrower-paid PMI products and establishing uniform procedures for the cancellation and termination of PMI policies.

## Scope and Effective Date

The act applies primarily to *residential mortgage transactions*, defined as mortgage loan transactions consummated on or after July 29, 1999, the purpose of which is to finance the acquisition, initial construction, or refinancing<sup>2</sup> of a single-family dwelling that serves as a borrower's primary residence.<sup>3</sup> It also includes provisions relating to annual written disclosures for *residential mortgages*, defined as mortgages, loans, or other evidences of a security interest created with respect to a single-family dwelling that is the borrower's primary residence. Condominiums, townhouses, and cooperative or mobile homes are considered single-family dwellings covered by the act.

The act's requirements vary depending on whether the mortgage

- Is a residential mortgage or a residential mortgage transaction
- Is defined as high risk (either by the lender, in the

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1. The act does not apply to mortgage insurance made available under the National Housing Act, title 38 of the U.S. Code, or title V of the Housing Act of 1949, including mortgage insurance on loans made by the Federal Housing Administration and guarantees on mortgage loans made by the Veterans Administration.

2. For purposes of this discussion, *refinancing* means the refinancing of a loan any portion of which is intended to provide financing for the acquisition or initial construction of a single-family dwelling that serves as a borrower's primary residence.

3. For purposes of this discussion, junior mortgages that provide financing for the acquisition, initial construction, or refinancing of a single-family dwelling that serves as a borrower's primary residence are covered.

case of nonconforming loans, or by Fannie Mae or Freddie Mac, in the case of conforming loans)

- Has a fixed rate or an adjustable rate
- Is covered by borrower-paid or lender-paid private mortgage insurance

## Cancellation and Termination of PMI: Non-High-Risk Residential Mortgage Transactions

### Borrower-Requested Cancellations

A borrower may initiate cancellation of PMI coverage by submitting a written request to the servicer. The servicer must take action to cancel PMI when

- The principal balance of the loan
  - Is first scheduled to reach 80 percent of the “original value”<sup>4</sup> (regardless of the outstanding balance), based on
    - The initial amortization schedule (in the case of a fixed-rate loan)
    - The amortization schedules (in the case of an adjustable-rate loan) or
  - Reaches 80 percent of the “original value,” based on actual payments
- The borrower has a good payment history<sup>5</sup>
- The borrower satisfies any requirement of the mortgage holder for
  - Evidence of a type established in advance that the value of the property has not declined below the original value and
  - Certification that the borrower’s equity in the property is not subject to a subordinate lien

Once PMI is canceled, the servicer may not require further PMI payments or premiums more than thirty days after the later of (1) the date on which the written request was received or (2) the date on which the borrower satisfied the mortgage holder’s evidence and certification requirements, described above.

### Automatic Termination

A servicer must automatically terminate PMI for residential mortgage transactions on the earliest date that both

- The principal balance of the mortgage is first

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4. *Original value* is defined as the lesser of the sales price of the secured property, as reflected in the purchase contract, or the appraised value at the time of loan consummation.

5. A borrower has a good payment history if he or she (1) has not made a payment that was sixty days or more past due within the first twelve months of the last two years prior to the cancellation date or (2) has not made a payment that was thirty days or more past due within twelve months of the cancellation date.

scheduled to reach 78 percent of the original value of the secured property (based solely on the initial amortization schedule, in the case of a fixed-rate loan, or on the amortization schedules, in the case of an adjustable-rate loan, regardless of the outstanding balance) and

- The borrower is current on mortgage payments.

If PMI is terminated, the servicer may not require further payments or premiums of PMI more than thirty days after (1) the termination date or (2) the date following the termination date on which the borrower becomes current on the payments, whichever is sooner.

There is no provision in the automatic-termination section of the act, as there is in the borrower-requested PMI cancellation section, that protects the lender against declines in property value or subordinate liens. The automatic-termination provisions make no reference to good payment history (as prescribed in the borrower-requested provisions) but state only that the borrower must be *current* on mortgage payments.

### Final Termination

If PMI coverage on a residential mortgage transaction was not canceled at the borrower’s request or by the automatic-termination provision, the servicer must terminate PMI coverage by the first day of the month following the date that is the midpoint of the loan’s amortization period if, on that date, the borrower is current on the payments required by the terms of the mortgage.

The servicer may not require further payments or premiums of PMI more than thirty days after PMI is terminated.

### Exclusions

The cancellation and termination provisions apply only to residential mortgage transactions for which the borrower pays the PMI. The provisions do not apply to those for which someone other than the borrower makes the payments.

### Return of Unearned Premiums

The servicer must return all unearned PMI premiums to the borrower within forty-five days after cancellation or termination of PMI coverage. Within thirty days after notification by the servicer of cancellation or termination of PMI coverage, a mortgage insurer must return to the servicer any amount of unearned premiums it is holding, to permit the servicer to return such premiums to the borrower.

## Exceptions to Cancellation and Termination of PMI: High-Risk Residential Mortgage Transactions

The borrower-requested cancellation at 80 percent LTV and the automatic termination at 78 percent LTV requirements do not apply to high-risk loans. However, high-risk loans are subject to final termination and are divided into two categories—conforming (Fannie Mae- and Freddie Mac-defined high-risk loans) and nonconforming (lender-defined high-risk loans).

### Conforming Loans

*Conforming loans* are loans that have an original principal balance not exceeding Freddie Mac's limit for conforming loans.<sup>6</sup> Fannie Mae and Freddie Mac are authorized under the act to establish a category of residential mortgage transactions that are not subject to the act's requirements for borrower-requested cancellation or automatic termination due to the high risk associated with them.<sup>7</sup> Such transactions are, however, subject to the final-termination provision of the act. As such, PMI on a conforming high-risk loan must be terminated by the first day of the month following the date that is the midpoint of the loan's initial amortization schedule (in the case of a fixed-rate loan) or amortization schedules (in the case of an adjustable-rate loan) if, on that date, the borrower is current on the loan. If the borrower is not current on that date, PMI must be terminated when the borrower does become current.

### Nonconforming Loans

*Nonconforming loans* are residential mortgage transactions that have an original principal balance exceeding Freddie Mac's and Fannie Mae's conforming loan limit. Lender-defined high-risk loans are not subject to the act's requirements for borrower-requested cancellation or automatic termination. However, if a residential mortgage transaction is a lender-defined high-risk loan, PMI must be terminated on the date on which the principal balance of the mortgage—based solely on the initial amortization schedule (in the case of a fixed-rate loan) or the amortization schedules (in the case of an adjustable-rate loan) for that mortgage—is first scheduled to reach 77 percent of the original value of the property securing the loan, regardless of the outstanding balance for that mortgage on that date.

6. The limit for 2005 was \$359,650.

7. As of the date of this publication Fannie Mae and Freddie Mac have not established such a category.

Like conforming loans that are determined by Freddie Mac and Fannie Mae to be high risk, a residential mortgage transaction that is a lender-defined high-risk loan is subject to the final-termination provision of the act.

## Basic Disclosure and Notice Requirements Applicable to Residential Mortgage Transactions and Residential Mortgages

At the time of consummation of a residential mortgage transaction, the lender must give the borrower certain disclosures that describe the borrower's rights with regard to PMI cancellation and termination. The requirements for initial disclosures vary depending on whether the transaction is a fixed-rate mortgage, an adjustable-rate mortgage, or a high-risk loan. Borrowers must also be given certain annual and other notices concerning PMI cancellation and termination. Borrowers may not be charged for any disclosure required by the act.

### Initial Disclosures for Fixed-Rate Residential Mortgage Transactions

When PMI is required for non-high-risk fixed-rate mortgages, the lender must provide to the borrower at the time the transaction is consummated

- A written initial amortization schedule and
- A written notice that discloses
  - The borrower's right to request cancellation of PMI and, based on the initial amortization schedule, the date on which the loan balance is scheduled to reach 80 percent of the original value of the property;
  - The borrower's right to request cancellation on an earlier date, if actual payments bring the loan balance to 80 percent of the original value of the property sooner than the date based on the initial amortization schedule;
  - That PMI will automatically terminate when the LTV ratio reaches 78 percent of the original value of the property, and the date on which that is projected to occur (based on the initial amortization schedule); and
  - That the act provides for exemptions to the cancellation and automatic-termination provisions for high-risk mortgages, and whether these exemptions apply to the borrower's loan.



## Initial Disclosures for Adjustable-Rate Residential Mortgage Transactions

When PMI is required for non-high-risk adjustable-rate mortgages, the lender must provide to the borrower, at the time the transaction is consummated, a written notice that discloses

- The borrower's right to request cancellation of PMI on (1) the date on which the loan balance is first scheduled to reach 80 percent of the original value of the property based on the amortization schedules or (2) the date on which the balance actually reaches 80 percent of the original value of the property based on actual payments. The notice must also state that the servicer will notify the borrower when either (1) or (2) occurs.
- That PMI will automatically terminate when the loan balance is first scheduled to reach 78 percent of the original value of the property based on the amortization schedules. The notice must also state that the borrower will be notified when PMI is terminated (or that termination will occur when the borrower becomes current on payments).
- That there are exemptions to the cancellation and automatic-termination provisions for high-risk mortgages, and whether such exemptions apply to the borrower's loan

## Initial Disclosures for High-Risk Residential Mortgage Transactions

When PMI is required for high-risk residential mortgage transactions, the lender must provide to the borrower a written notice stating that PMI will not be required beyond the date that is the midpoint of the loan's amortization schedule if, on that date, the borrower is current on the payments as required by the terms of the loan. The lender must provide this notice at consummation. The lender need not provide disclosure of the termination at 77 percent LTV for lender-defined high-risk mortgages.

## Annual Disclosures for Residential Mortgage Transactions

For all residential mortgage transactions, including high-risk mortgages for which PMI is required, the servicer must provide to the borrower an annual written statement that sets forth the rights of the borrower to cancel and terminate PMI and the address and telephone number that the borrower may use to contact the servicer to determine whether the borrower may cancel PMI.

## Disclosures for Existing Residential Mortgages

For residential mortgages consummated before the act took effect (on July 29, 1999), if PMI was required, the servicer must provide to the borrower an annual written statement that

- States that PMI may be canceled with the consent of the lender or in accordance with state law and
- Provides the servicer's address and telephone number so that the borrower can contact the servicer to determine whether the borrower may cancel PMI.

## Notification upon Cancellation or Termination of PMI Relating to Residential Mortgage Transactions

### General Requirements

Not later than thirty days after PMI relating to a residential mortgage transaction is canceled or terminated, the servicer must notify the borrower in writing that

- PMI has terminated and the borrower no longer has PMI and
- No further premiums, payments, or other fees are due or payable by the borrower in connection with PMI.

### Notice of Grounds, and Timing of Notice

If a servicer determines that a borrower in a residential mortgage transaction does not qualify for cancellation or automatic termination of PMI, the servicer must provide to the borrower a written notice of the grounds relied on for making that determination. If an appraisal was used in making the determination, the servicer must give the results of the appraisal to the borrower. If a borrower does not qualify for cancellation, the notice must be provided not later than thirty days following the later of (1) the date the borrower's request for cancellation was received or (2) the date on which the borrower satisfied any of the mortgage holder's evidence and certification requirements. If the borrower does not meet the requirements for automatic termination, the notice must be provided not later than thirty days following the scheduled termination date.

## Disclosure Requirements for Lender-Paid Mortgage Insurance

### Definitions

- *Borrower-paid mortgage insurance (BPMI)*—PMI that is required in connection with a residential mortgage transaction, the payments for which are made by the borrower
- *Lender-paid mortgage insurance (LPMI)*—PMI that is required in connection with a residential mortgage transaction, the payments for which are made by a person other than the borrower
- *Loan commitment*—A prospective lender's written confirmation of its approval of a prospective borrower's application for a residential mortgage loan (including any applicable closing conditions)

### Initial Notice

In the case of LPMI that is required in connection with a residential mortgage transaction, the lender must provide a written notice to the borrower not later than the date on which a loan *commitment* is made. The written notice must advise the borrower of the differences between LPMI and BPMI by notifying the borrower that LPMI

- Differs from BPMI because it cannot be canceled by the borrower or automatically terminated as provided under the act,
- Usually results in a mortgage having a higher interest rate than it would in the case of BPMI, and
- Terminates only when the mortgage is refinanced, paid off, or otherwise terminated.

The notice must also contain

- A statement that both LPMI and BPMI have benefits and disadvantages,
- A generic analysis of the costs and benefits of a mortgage in the case of LPMI versus BPMI over a ten-year period, assuming prevailing interest and property appreciation rates, and
- A statement that LPMI may be tax deductible for purposes of federal income taxes, if the borrower itemizes expenses for that purpose.

### Notice at Termination Date

Not later than thirty days after the termination date that would apply in the case of BPMI, the servicer must provide to the borrower a written notice indicating that the borrower may wish to review financing options that could eliminate the requirement for LPMI in connection with the mortgage.

## Fees for Disclosures

As stated previously, no fee or other cost may be imposed on borrowers for the disclosures and notifications that lenders and servicers are required to give them.

## Civil Liability

### Liability Dependent on Type of Action

Servicers, lenders, and mortgage insurers that violate the act are liable to borrowers as follows:

- *Individual action*—In the case of individual borrowers,
  - Actual damages (including interest accruing on such damages),
  - Statutory damages not to exceed \$2,000,
  - Costs of the action, and
  - Reasonable attorney's fees.
- *Class action*

In the case of a class action suit against a defendant that is subject to section 10 of the act (that is, an entity regulated by a federal banking agency, the NCUA, or the Farm Credit Administration),

- Such statutory damages as the court may allow up to the lesser of \$500,000 or 1 percent of the liable party's net worth,
- Costs of the action, and
- Reasonable attorney's fees.

In the case of a class action suit against a defendant that is not subject to section 10 of the act (that is, an entity not regulated by a federal banking agency, NCUA, or the Farm Credit Administration),

- Actual damages (including interest accruing on such damages),
- Statutory damages up to \$1,000 per class member but not to exceed the lesser of \$500,000 or 1 percent of the liable party's gross revenues,
- Costs of the action, and
- Reasonable attorney's fees.

### Statute of Limitations

A borrower must bring an action under the act within two years after the borrower discovers the violation.

### Mortgage-Servicer Liability Limitation

A servicer is not liable for its failure to comply with the requirements of the act if the servicer's failure to

comply is due to the mortgage insurer's or lender's failure to comply with the act.

### Federal Preemption

For residential mortgage transactions, the provisions of the act supersede state laws, except for those states that had PMI laws in effect as of January 2, 1998.<sup>8</sup> Laws in these states are preempted only to the extent that they are less protective than the act. These states were permitted two years from the date of enactment (that is, until July 29, 2000) to amend their laws in light of the provisions of the act.

The provisions of the act also supersede any conflicting provision contained in any agreement relating to the servicing of a residential mortgage loan entered into by Fannie Mae, Freddie Mac, or

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8. Eight states (California, Colorado, Connecticut, Maryland, Massachusetts, Minnesota, Missouri, and New York) had PMI laws in effect prior to January 2, 1998. See 144 Cong. Rec. 5,432 (daily ed. July 14, 1998; statement by Rep. LaFalce).

any private investor or note holder (or any successor thereto).

### Enforcement

The act directs the federal banking agencies to enforce the act under 12 USC 1818 or any other authority conferred upon the agencies by law. The agencies are required to

- Notify applicable lenders or servicers of any failure to comply with the act,
- Require the lender or servicer, as applicable, to correct the borrower's account to reflect the date on which PMI should have been canceled or terminated under the act, and
- Require the lender or servicer, as applicable, to return unearned PMI premiums to a borrower who paid premiums after the date on which the borrower's obligation to pay PMI premiums ceased under the act.

# Homeowners Protection Act Examination Objectives and Procedures

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## EXAMINATION OBJECTIVES

1. To determine the financial institution's compliance with the Homeowners Protection Act of 1998 (HOPA)
2. To assess the quality of the financial institution's policies and procedures for implementing the HOPA
3. To determine the reliance that can be placed on the financial institution's internal controls and procedures for monitoring the institution's compliance with the HOPA
4. To initiate corrective action when violations of HOPA are identified or when policies or internal controls are deficient

## EXAMINATION PROCEDURES

1. Through discussions with management and review of available information, determine if the institution's internal controls are adequate to ensure compliance with the Homeowners Protection Act. Consider the following:
  - a. Organization charts
  - b. Process flow charts
  - c. Policies and procedures
  - d. Loan documentation
  - e. Checklists
  - f. Training
  - g. Computer program documentation
2. Review any compliance audit materials, including workpapers and reports, to determine whether
  - a. The institution's procedures address all applicable provisions of the HOPA
  - b. Steps are taken to follow up on previously identified deficiencies
  - c. The procedures used include samples covering all product types and decision centers
  - d. The compliance audit work performed is accurate
  - e. Significant deficiencies and their causes are included in reports to management and to the board of directors
  - f. Corrective action is taken in a timely and appropriate manner
  - g. The frequency of compliance review is appropriate

3. Complete the HOPA worksheet by reviewing disclosure and notification forms and the financial institution's policies and procedures. As applicable, the forms should include
  - Initial disclosures for (1) fixed-rate mortgages, (2) adjustable-rate mortgages, (3) high-risk loans, and (4) lender-paid mortgage insurance
  - Annual notices for (1) fixed- and adjustable-rate mortgages and high-risk loans and (2) existing residential mortgages
  - Notices of (1) cancellation, (2) termination, (3) grounds for not canceling PMI, (4) grounds for not terminating PMI, (5) cancellation date for adjustable-rate mortgages, and (6) termination date for lender-paid mortgage insurance
4. Confirm that borrowers are not charged for any required disclosures or notifications. (§ 7 of the HOPA)
5. Obtain and review a sample of recent written requests from borrowers to cancel their PMI on non-high-risk residential mortgage transactions. Verify that the insurance was canceled on either (1) the date on which the principal balance of the loan was first scheduled to reach 80% of the original value of the property based on the initial amortization schedule (in the case of a fixed-rate loan) or the amortization schedules (in the case of an adjustable-rate loan) or (2) the date on which the principal balance of the loan actually reached 80% of the original value of the property based on actual payments, if all the applicable provisions in section 3(a) of the HOPA were satisfied (that is, good payment history and, if required by the lender, evidence that the value of the mortgaged property did not decline, and certification that the borrower's equity was unencumbered by a subordinate lien). (§ 3(a))
6. Obtain and review a sample of non-high-risk PMI residential mortgage transactions. Verify that PMI was terminated, based on the initial amortization schedule (in the case of a fixed-rate loan) or the amortization schedules (in the case of an adjustable-rate loan), on the date on which the principal balance of the loan was first scheduled to reach 78% of the original value of the mortgaged property, assuming that the borrower was current, or on the earliest date thereafter on which the borrower became current. (§ 3(b))

7. Obtain a sample of PMI-covered residential mortgage transactions (including high-risk loans, if any) that have reached the midpoint of their amortization period. Determine whether PMI was terminated by the first day of the following month if the loan was current. If the loan was not current at the midpoint, determine that PMI was terminated by the first day of the month following the day the loan became current. If at the time of the examination a loan at the midpoint is not current, determine whether the financial institution is monitoring the loan and has systems in place to ensure that PMI is terminated when the borrower becomes current. (§§ 3(c) and 3(f)(2))
8. Determine if the financial institution has made any lender-defined high-risk residential mortgage transactions. If so, select a sample of these transactions and verify that PMI was canceled, based on the initial amortization schedule (in the case of a fixed-rate loan) or the amortization schedules (in the case of an adjustable-rate loan), on the date on which the principal balance of the loan was scheduled to reach 77% of the original value of the mortgaged property. (§ 3(f)(1)(B))
9. Obtain a sample of loans that have had PMI canceled or terminated. For PMI loans canceled upon the borrower's request, determine that the financial institution did not require any PMI payments beyond 30 days of the borrower's satisfying the evidence and certification requirements to cancel PMI. (§ 3(d)(1)) For

PMI loans that received automatic termination or final termination, determine that the financial institution did not require any PMI payments beyond 30 days of termination. (§§ 3(d)(2) and 3(d)(3))

10. Using the samples in steps 5, 6, and 7, determine if the financial institution returns unearned premiums, if any, to the borrower within 45 days after cancellation or termination of PMI. (§ 3(e)(1))

## Conclusions

11. Summarize all violations.
12. If the violation (or violations) noted represents a pattern or practice, determine the root cause by identifying weaknesses in internal controls, compliance review, training, management oversight, or other factors.
13. Identify action needed to correct violations and weaknesses in the institution's compliance system, as appropriate.
14. Discuss findings with the institution's management, and obtain a commitment for corrective action.
15. Determine if enforcement action is appropriate. If so, contact appropriate Reserve Bank personnel for guidance. Section 10(c) of the act contains a provision requiring restitution of unearned PMI premiums.

# Homeowners Protection Act Worksheet

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1. For *fixed-rate* residential mortgage transactions, does the lender provide, at consummation, written initial disclosures that include the following?
- |   |     |    |     |
|---|-----|----|-----|
| a. A written amortization schedule (§ 4(a)(1)(A)(i))  | Yes | No | N/A |
| b. A notice that the borrower may submit a written request to cancel PMI as of the date that, based on the initial amortization schedule, the principal balance is first scheduled to reach 80% of the original value of the mortgaged property, regardless of the outstanding balance of the mortgage; or such earlier date that, based on actual payments, the principal balance actually reaches 80% of the original value of the mortgaged property, and provided that the borrower has a good payment history and has satisfied the lender's requirements that the value of the mortgaged property has not declined and is unencumbered by subordinate liens (§§ 4(a)(1)(A)(ii)(I) and 4(a)(1)(A)(ii)(II)) | Yes | No | N/A |
| c. The specific date, based on the initial amortization schedule, on which the loan balance is scheduled to reach 80% of the original value of the mortgaged property (§ 4(a)(1)(A)(ii)(I))   | Yes | No | N/A |
| d. A notice that PMI will automatically terminate on the date that, based on the amortization schedule and regardless of the outstanding balance of the mortgage, the principal balance is first scheduled to reach 78% of the original value of the mortgaged property, provided that the loan is current (§ 4(a)(1)(A)(ii)(III))  | Yes | No | N/A |
| e. The specific date the loan balance is scheduled to reach 78% LTV (§ 4(a)(1)(A)(ii)(III))   | Yes | No | N/A |
| f. Notice that exemptions to the borrower's right to cancel PMI and automatic PMI termination exist for high-risk loans, and whether such exemptions apply (§ 4(a)(1)(A)(ii)(IV))   | Yes | No | N/A |
2. For *adjustable-rate* residential mortgage transactions, does the lender provide, at consummation, written initial disclosures that include a notice that
- |  |     |    |     |
|--|-----|----|-----|
| a. The borrower may submit a written request to cancel PMI as of the date that, based on the amortization schedule(s) and regardless of the outstanding balance of the mortgage, the principal balance is first scheduled to reach 80% of the original value of the mortgaged property; or such earlier date that, based on actual payments, the principal balance actually reaches 80% of the original value of the mortgaged property and the borrower has a good payment history and has satisfied the lender's requirements that the value of the mortgaged property has not declined and is unencumbered by subordinate liens (§ 4(a)(1)(B)(i)) | Yes | No | N/A |
| b. The servicer will notify the borrower when the cancellation date is reached, that is, when the loan balance represents 80% of the original value of the mortgaged property (§ 4(a)(1)(B)(I))  | Yes | No | N/A |
| c. PMI will automatically terminate when the loan balance is first scheduled to reach 78% of the original value of the mortgaged property, regardless of the outstanding balance of the mortgage, and the loan is current (§ 4(a)(1)(B)(ii))   | Yes | No | N/A |
| d. On the termination date the borrower will be notified of the termination or the fact that PMI will be terminated when the loan is brought current (§ 4(a)(1)(B)(ii))  | Yes | No | N/A |

e. Exemptions to the borrower's right to cancel PMI and automatic PMI termination exist for high-risk loans, and whether such exemptions apply (§ 4(a)(1)(B)(iii))	Yes	No	N/A
3. Does the lender have established standards regarding the type of evidence it requires borrowers to provide to demonstrate that the value of the mortgage property has not declined, and are they provided when a request for cancellation occurs?	Yes	No	N/A
4. For high-risk residential mortgage transactions (as defined by the lender or Fannie Mae or Freddie Mac), does the lender provide, at consummation, written initial disclosures that PMI will not be required beyond the midpoint of the amortization period of the loan, if the loan is current? (§ 4(a)(2))	Yes	No	N/A
5. If the financial institution acts as servicer for residential mortgage transactions, does it provide an annual written statement to the borrowers explaining their rights to cancel or terminate PMI and an address and telephone number where the servicer can be contacted to determine whether they may cancel PMI? (§ 4(a)(3)) (Note: This disclosure may be included on the RESPA annual escrow account disclosure or the IRS interest payment disclosures.)	Yes	No	N/A
6. If the financial institution acts as servicer, does it provide an annual written statement to each borrower who entered into a residential mortgage prior to July 29, 1999, that includes			
a. A statement that PMI may, under certain circumstances, be canceled by the borrower with the consent of the lender or in accordance with applicable state law (§ 4(b)(1))	Yes	No	N/A
b. An address and telephone number that the borrower may use to contact the servicer to determine whether the borrower may cancel the PMI (§ 4(b)(2))	Yes	No	N/A
(Note: This disclosure may be included on the RESPA annual escrow account disclosure or the IRS interest payment disclosure.)			
7. If the financial institution acts as servicer for residential mortgage transactions, does it provide borrowers written notice within 30 days after the date of cancellation or termination of PMI that the borrower no longer has PMI and that no further PMI payments or related fees are due? (§ 5(a))	Yes	No	N/A
8. If the financial institution services residential mortgage transactions, does it return all unearned PMI premiums to the borrower within 45 days of either termination upon the borrower's request or automatic termination under the HOPA? (§ 3(e))	Yes	No	N/A
9. If the financial institution acts as servicer for residential mortgage transactions, does it provide borrowers written notice of the grounds it relied on (including the results of any appraisal) to deny a borrower's request for PMI cancellation no later than 30 days after the date the request is received or the date on which the borrower satisfies any evidence and certification requirements established by the lender, whichever is later? (§§ 5(b)(1) and 5(b)(2)(A))	Yes	No	N/A
10. If the financial institution acts as servicer for residential mortgage transactions, does it provide borrowers written notice of the grounds it relied on (including the results of any appraisal) in refusing to automatically terminate PMI not later than 30 days after the scheduled termination date? (§ 5(b)(2)(B))	Yes	No	N/A

(Note: The scheduled termination date is reached when, based on the initial amortization schedule (in the case of a fixed-rate loan) or the amortization schedules (in the case of an adjustable-rate loan), the principal balance of the loan is first scheduled to reach 78% of the original value of the mortgaged property, assuming that the borrower is current on that date, or the earliest date thereafter on which the borrower becomes current.)

11. If the financial institution acts as a servicer for adjustable-rate residential mortgage transactions, does it notify borrowers that the cancellation date has been reached? (§ 4(a)(1)(B)(i))	Yes	No	N/A
12. If the financial institution acts as a servicer for adjustable-rate residential mortgage transactions, does it notify the borrowers on the termination date that PMI has been canceled or will be canceled as soon as the borrower is current on loan payments? (§ 4(a)(1)(B)(ii))	Yes	No	N/A
13. If the financial institution requires "lender paid mortgage insurance" (LPMI) for residential mortgage transactions, does it provide a written notice to a prospective borrower on or before the loan commitment date that includes the following?			
a. A statement that LPMI differs from borrower-paid mortgage insurance (BPMI) in that the borrower may not cancel LPMI, while BPMI is subject to cancellation and automatic termination under the HOPA (§ 6(c)(1)(A))	Yes	No	N/A
b. A statement that LPMI usually results in a mortgage with a higher interest rate than BPMI (§ 6(c)(1)(B)(i))	Yes	No	N/A
c. A statement that LPMI terminates only when the transaction is refinanced, paid off, or otherwise terminated (§ 6(c)(1)(B)(ii))	Yes	No	N/A
d. A statement that both LPMI and BPMI have benefits and disadvantages, and a generic analysis reflecting the differing costs and benefits of each over a 10-year period, assuming prevailing interest and property appreciation rates (§ 6(c)(1)(C))	Yes	No	N/A
e. A statement that LPMI may be tax deductible on federal income taxes if the borrower itemizes expenses for that purpose (§ 6(c)(1)(D))	Yes	No	N/A
14. If the lender requires LPMI for residential mortgage transactions and the financial institution acts as servicer, does it notify the borrower in writing within 30 days of the termination date that would have applied, if it were a BPMI transaction, that the borrower may wish to review financing options that could eliminate the requirement for PMI? (§ 6(c)(2))	Yes	No	N/A
15. Does the financial institution prohibit borrower-paid fees for the disclosures and notifications required under the HOPA? (§ 7)	Yes	No	N/A





# Homeownership Counseling

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## Background

Section 106(c)(5) of the Housing and Urban Development Act of 1968 (12 USC 1701x(c)(5)) provides for homeownership counseling notification by creditors to eligible homeowners. The act has been amended at various times, most recently in November 2001 when the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act of 2002 (Pub. L. 107-73) was enacted.<sup>1</sup> Section 205 of that act repealed the previous sunset provision.

## Applicability

All creditors that service loans secured by a mortgage or lien on a single-family residence (home loans) are subject to the homeownership counseling notification requirements. Home loans include conventional mortgage loans and loans insured by the Department of Housing and Urban Development (HUD).

## Requirements

### Notice Requirements

A creditor must provide notification of the availability of homeownership counseling to a homeowner who is eligible for counseling and who fails to pay any amount by the due date under the terms of the home loan.<sup>2</sup>

### Eligibility

A homeowner is eligible for counseling if

- The loan is secured by the homeowner's principal residence,
- The home loan is not assisted by the Farmers Home Administration, and

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1. Section 577 of the National Affordable Housing Act of 1990 (Pub. L. 101-625) extended the homeownership counseling provisions to September 30, 1992; section 162 of the Housing and Community Development Act of 1992 (Pub. L. 102-550) extended the provisions to September 30, 1994; and section 594 of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act of 1999 (Pub. L. 105-276) extended the provisions to September 30, 2000.

2. The FFIEC Consumer Compliance Task Force has requested clarification from HUD on HUD's current position regarding notice requirements related to first-time homebuyers. The interagency examination procedures included in this chapter are currently limited to determining compliance with the act's notice provisions related to delinquent borrowers. However, should a response from HUD to the task force indicate that notices to first-time homebuyers should be provided under the act, the examination procedures will be expanded to cover notices to first-time homebuyers.

- The homeowner is, or is expected to be, unable to make payments, correct a home loan delinquency within a reasonable time, or resume full home loan payments due to a reduction in the homeowner's income because of
  - An involuntary loss of, or reduction in, the homeowner's employment, the homeowner's self-employment, or income from the pursuit of the homeowner's occupation or
  - Any similar loss or reduction experienced by any person who contributes to the homeowner's income.

## Contents of Notice

The notice must

- Notify the homeowner of the availability of any homeownership counseling offered by the creditor and
- Provide either a list of HUD-approved nonprofit homeownership counseling organizations or the toll-free number HUD has established through which a list of such organizations can be obtained.<sup>3</sup>

## Timing of Notice

The notice must be given to a delinquent homeowner borrower no later than forty-five days after the date on which the homeowner becomes delinquent. If, within the forty-five-day period, the borrower brings the loan current again, no notification is required.

## Definitions

For purposes of these requirements, the following definitions apply:

- *Creditor*—A person or entity that is servicing a home loan on behalf of itself or another person or entity
- *Home loan*—A loan secured by a mortgage or lien on residential property
- *Homeowner*—A person who is obligated under a home loan
- *Residential property*—A single-family residence, including a single-family unit in a condominium project, a membership interest and occupancy agreement in a cooperative housing project, and a manufactured home and the lot on which the home is situated

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3. The toll-free number is 1-800-569-4287.



# Homeownership Counseling Examination Objectives and Procedures

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## EXAMINATION OBJECTIVES

To determine whether the financial institution has established procedures regarding homeownership counseling notification requirements in order to ensure that it is in compliance with the provisions of section 106(c)(5) of the Housing and Urban Development Act of 1968.

homeownership counseling offered by the creditor and (2) the availability of any homeownership counseling by nonprofit organizations approved by HUD, or the toll-free telephone number through which the homeowner can obtain a list of such organizations.

## EXAMINATION PROCEDURES

1. Determine if the financial institution is informing eligible homeowners, within 45 days of initial loan default, of (1) the availability of any



# Homeownership Counseling Examination Checklist

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- |   |     |    |
|---|-----|----|
| 1. Does the financial institution notify eligible homeowners, within 45 days of initial loan default, of any homeownership counseling the institution (creditor) provides?                                | Yes | No |
| 2. Does the financial institution provide eligible homeowners with the names of nonprofit organizations approved by HUD or the toll-free telephone number to call to obtain a list of such organizations? | Yes | No |



# Real Estate Settlement Procedures Act

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## Background

The Real Estate Settlement Procedures Act of 1974 (RESPA) (12 USC 2601-17), which is implemented by the Department of Housing and Urban Development's Regulation X (24 CFR 3500), became effective in June 1975. The act requires lenders, mortgage brokers, and servicers of home loans to provide borrowers with pertinent and timely disclosures about the nature and costs of the real estate settlement process. It also protects borrowers against certain abusive practices, such as kick-backs, and places limitations on the use of escrow accounts.

Since its enactment, RESPA has been amended several times to cover, among other things, subordinate loans; required disclosures for the transfer, sale, or assignment of mortgage servicing; rules for mortgage escrow accounts, including the accounting method to be used for these accounts; required disclosures; and the established formats and procedures for initial and annual escrow statements.

## Coverage—Section 3500.5(a)

RESPA is applicable to all federally related mortgage loans. *Federally related mortgage loans* are loans, including refinances, secured by a first or subordinate lien on residential real property upon which

- A one- to four-family structure is located or is to be constructed using proceeds of the loan (including individual units of condominiums and cooperatives) or
- A manufactured home is located or is to be constructed using proceeds of the loan

In addition, the federally related mortgage loan must meet one of the following conditions:

- Made by a lender,<sup>1</sup> creditor,<sup>2</sup> or dealer<sup>3</sup>
- Made by or insured by an agency of the federal government

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1. A *lender* includes a financial institution either regulated by or whose deposits or accounts are insured by any agency of the federal government.

2. A *creditor* is defined in section 103(f) of the Consumer Credit Protection Act (15 USC 1602(f)). RESPA covers any creditor that makes or invests in residential real estate loans aggregating to more than \$1,000,000 a year.

3. *Dealer* is defined in Regulation X as a seller, contractor, or supplier of goods or services. Dealer loans are covered by RESPA if the obligations are to be assigned before the first payment is due to any lender or creditor otherwise subject to the regulation.

- Made in connection with a housing or urban development program administered by an agency of the federal government
- Made by and intended to be sold by the originating lender or creditor to FNMA, GNMA, or FHLMC (or its successor)<sup>4</sup>
- Subject of a home equity conversion mortgage or a reverse mortgage issued by a lender or creditor subject to the regulation
- Made by a lender, dealer, or creditor subject to the regulation and used in whole or in part to fund an installment sales contract, land contract, or contract for deed on otherwise qualifying residential property

## Exemptions—Section 3500.5(b)

The following transactions are exempt from RESPA:

- A loan on property of twenty-five acres or more (whether or not a dwelling is located on the property)
- A loan primarily for business, commercial, or agricultural purposes (as defined in section 226.3(a)(1) of Regulation Z)
- A temporary loan, such as a construction loan (The exemption does not apply if the loan is used as, or may be converted to, permanent financing by the same financial institution.) If the lender issues a commitment for permanent financing, the loan is covered. A construction loan with a term of two years or more is covered unless it is made to a bona fide contractor. "Bridge" and "swing" loans are not covered.
- A loan secured by vacant or unimproved property when no proceeds of the loan will be used to construct a one- to four-family residential structure. If the proceeds will be used to locate a manufactured home or construct a structure within two years from the date of settlement, the loan is covered.
- An assumption, unless the mortgage instruments require lender approval for the assumption and the lender actually approves the assumption
- A renewal or modification when the original obligation (note) is still in effect but modified
- A bona fide transfer of a loan obligation in the secondary market (However, the mortgage servicing transfer disclosure requirements of

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4. FNMA, Federal National Mortgage Association; GNMA, Government National Mortgage Association; FHLMC, Federal Home Loan Mortgage Corporation.



24 CFR 3500.21 still apply.) Mortgage broker transactions that are table-funded (that is, the loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds) are not secondary-market transactions and therefore are covered by RESPA.

The exemption does not apply if there is a transfer of title to the property.

## Requirements

### Special Information Booklet (§ 3500.6)

A financial institution is required to provide a borrower with a copy of the “special information booklet” at the time a written application is submitted or no later than three business days after the application is received. If the application is denied before the end of the three-business-day period, the institution is not required to provide the booklet. If the borrower uses a mortgage broker, the broker rather than the institution must provide the booklet.

- An application includes the submission of a borrower’s financial information, either written or computer generated, for a credit decision on a federally related mortgage loan. To be considered a written application, the submission must state or identify a specific property. The subsequent addition of an identified property to the submission converts the submission to an application for a federally related mortgage loan. (section 3500.2(b))
- A financial institution that complies with Regulation Z for open-end home equity plans is deemed to have complied with this section of the regulation.
- The booklet does not need to be given for refinancing transactions, closed-end subordinate-lien mortgage loans, or reverse mortgage transactions or for any other federally related mortgage loan not intended for the purchase of a one- to four-family residential property.

Part 1 of the booklet describes the settlement process and the nature of charges and suggests questions to be asked of lenders, attorneys, and others to clarify what services they will provide for the charges quoted. It also contains information on the rights and remedies available under RESPA and alerts borrowers to unfair or illegal practices.

Part 2 contains an itemized explanation of settlement services and costs, as well as sample forms and worksheets for comparing costs. The appendix in the booklet has a list of consumer literature on home purchasing, maintenance protection, and related topics.

### Good Faith Estimates of the Amount or Range of Settlement Costs (§ 3500.7)

A financial institution must provide, in a clear and concise form, a good faith estimate (GFE) of the amount of settlement charges the borrower is likely to incur. The GFE must include all charges that will be listed in section L of the HUD-1 settlement statement and must be provided no later than three business days after the written application is received. The estimate for each settlement service may be an estimate of the dollar amount or a range of dollar amounts. However the estimate is stated (amount or range), for each charge the estimate (1) must bear a reasonable relationship to the borrower’s ultimate cost for each settlement charge and (2) must be based on experience in the locality or area in which the property involved is located. A suggested form is set forth in appendix C to Regulation X. If the application is denied before the end of the three-business-day period, the institution is not required to provide a GFE.

- A financial institution that complies with Regulation Z for open-end home equity plans is deemed to have complied with this section.
- For “no cost” or “no point” loans, the GFE must disclose any payments to be made to affiliated or independent settlement service providers. These payments should be shown as P.O.C. (paid outside of closing).
- For dealer loans, the institution is responsible for providing the GFE directly to the consumer or for ensuring that it is provided by the dealer.
- For brokered loans, if the mortgage broker is the exclusive agent of the institution, either the institution or the broker must provide the GFE within three business days after the broker receives or prepares the application. When the broker is not the exclusive agent of the institution, the institution is not required to provide the GFE if the broker has already provided it. However, the funding lender must ascertain that the GFE has been delivered.

If the financial institution requires the use of a particular settlement service provider and requires the borrower to pay all or a portion of the cost of those services, the institution must include with the GFE the following disclosures:

- A statement that use of the provider is required and that the estimate is based on the charges of the designated provider
- The name, address, and telephone number of the designated provider
- A description of the nature of any relationship between each such provider and the institu-

tion. A relationship exists if any of the following apply:

- The provider is an associate of the institution, as defined in section 3(8) of RESPA (12 USC 2602(8))
- The provider has maintained an account with the institution or had an outstanding loan or credit arrangement with the institution within the past twelve months
- The institution has repeatedly used or required borrowers to use the provider's services within the past twelve months
- A statement explaining that except for a provider that is the institution's chosen attorney, credit-reporting agency, or appraiser, if the institution has an affiliated business relationship with the provider, the institution may not require use of that provider (24 CFR 3500.15)

If the institution maintains a controlled list of required providers (five or more for each discrete service) or relies on a list maintained by others and at the time of the application has not decided which provider will be selected, the institution may comply with this section by

- Providing a written statement that the institution will require a particular provider from an approved list and
- Disclosing in the GFE the range of costs for the required providers and providing the name of the specific provider and the actual cost on the HUD settlement statement

If the list contains fewer than five providers of service, the names, addresses, telephone numbers, and costs are required along with an explanation of the business relationship.

### Uniform Settlement Statements (HUD-1 and HUD-1A) (§ 3500.8)

The HUD-1 and HUD-1A settlement statements must be completed by the person (settlement agent) conducting the closing and must conspicuously and clearly itemize all charges related to the transaction. The HUD-1 is used for transactions in which there is a borrower and a seller. It may also be used for transactions in which there is a borrower but no seller (refinancings and subordinate-lien loans) by completing the borrower's side of the statement; alternatively, the HUD-1A may be used for borrower-only transactions.

No settlement statement is required for home equity plans subject to the Truth in Lending Act and Regulation Z.

Appendix A to Regulation X gives instructions for completing the two forms.

### *Printing and Duplication of Settlement Statements* (§ 3500.9)

Financial institutions have numerous options for layout and format in reproducing the HUD-1 and HUD-1A settlement statements. The following variations do not require prior HUD approval: size of pages; tint or color of pages; size and style of type or print; spacing; printing on separate pages, the front and back of a single page, or one continuous page; use of multicopy tear-out sets; printing on rolls for computer purposes; addition of signature lines; and translation into any language. Other changes may be made only with the approval of the Secretary of Housing and Urban Development.

### *One-Day Advance Inspection of Settlement Statements* (§ 3500.10)

Upon request by the borrower, the HUD-1 or HUD-1A settlement statement must be completed and made available for inspection during the business day immediately preceding the day of settlement. The statement must set forth those items known at that time by the person conducting the closing.

### *Delivery of Settlement Statements* (§§ 3500.10(a) and 3500.10(b))

The completed HUD-1 or HUD-1A settlement statement must be mailed or delivered to the borrower, the seller (if there is one), and the lender (if the lender is not the settlement agent) or their agents at or before settlement. However, the borrower may waive the right of delivery by executing a written waiver at or before settlement. If the borrower or the borrower's agent does not attend the settlement, the settlement statement must be mailed or delivered as soon as practicable after settlement.

### *Retention of Settlement Statements* (§ 3500.10(e))

The financial institution must retain each completed HUD-1 or HUD-1A settlement statement and related documents for five years after settlement, unless the institution disposes of its interest in the mortgage and does not service the mortgage. If the loan is transferred, the institution must provide a copy of the statement to the owner or servicer of the mortgage as part of the transfer. The owner or servicer must retain the statement for the remainder of the five-year period.

## Prohibition of Fees for Preparing Federal Disclosures— Section 3500.12

For loans subject to RESPA, no fee may be charged for preparing the settlement statement or the escrow account statement or any disclosures required by the Truth in Lending Act.

## Prohibition against Kickbacks and Unearned Fees—Section 3500.14

Any person who gives or receives a fee or a thing of value (a payment, commission, fee, gift, or special privilege) for the referral of settlement business is in violation of section 8 of RESPA. Payments in excess of the reasonable value of goods provided or services rendered are considered kickbacks. Appendix B to Regulation X provides guidance on the meaning and coverage of the prohibition against kickbacks and unearned fees.

### Penalties and Liabilities

Civil and criminal liability is provided for violating the prohibition against kickbacks and unearned fees, including

- Civil liability to the parties affected equal to three times the amount of any charge paid for such settlement service
- The possibility that the costs associated with any court proceeding, together with reasonable attorney's fees, could be recovered
- A fine of not more than \$10,000 or imprisonment for not more than one year, or both, for each violation

## Affiliated Business Arrangements— Section 3500.15

If a financial institution has either an affiliate relationship or a direct or beneficial ownership interest of more than 1 percent in a provider of settlement services and the lender directly or indirectly refers business to the provider, this relationship is an affiliated business arrangement. An affiliated business arrangement is not a violation of section 8 of RESPA or of section 3500.14 of Regulation X if the following conditions are satisfied:

- Prior to the referral, the person making each referral has provided, to each person whose business is referred, an affiliated business arrangement disclosure statement (Appendix D to Regulation X). This disclosure must specify both

- The nature of the relationship (explaining the ownership and financial interest) between the provider and the financial institution and
- The estimated charge or range of charges generally made by such provider

This disclosure must also be provided on a separate piece of paper either at the time of loan application, or with the GFE, or at the time of the referral.

Generally, the institution may not require the use of such a provider. The institution may, however, require a buyer, borrower, or seller to pay for the services of an attorney, credit-reporting agency, or real estate appraiser chosen by the institution to represent its interest. The only thing of value the institution may receive is a return on an ownership or franchise interest or a payment otherwise permitted by RESPA.

## Title Companies—Section 3500.16

Financial institutions that hold legal title to the property being sold are prohibited from requiring borrowers, either directly or indirectly, to use a particular title company. Civil liability for violating this provision is an amount equal to three times the total of all charges made for such title insurance.

## Escrow Accounts—Section 3500.17

HUD's escrow accounting rule, known as aggregate accounting, establishes formats and procedures for initial and annual escrow account statements.

Under the rule, the amount of escrow funds that may be collected at settlement or upon creation of an escrow account is restricted to an amount sufficient to pay charges, such as taxes and insurance, that are attributable to the period from the date such payments were last paid until the initial payment date. Throughout the life of an escrow account, the servicer may charge the borrower a monthly sum equal to one-twelfth of the total annual escrow payments that the servicer reasonably anticipates paying from the account. In addition, the servicer may add an amount to maintain a cushion no greater than one-sixth of the estimated total annual payment from the account.

### Escrow Account Analysis (§§ 3500.17(c)(2) and 3500.17(c)(3))

Before establishing an escrow account, a servicer must conduct an analysis to determine the periodic payments and the amount to be deposited. The servicer must use an escrow disbursement date

that is on or before the earlier of (1) the deadline to take advantage of discounts, if available, or (2) the deadline to avoid a penalty. The servicer must also analyze each account at the completion of the computation year to determine the borrower's monthly payments for the next computation year.

### Transfer of Servicing (§ 3500.17(e))

If a new servicer changes either the monthly payment amount or the accounting method used by the former servicer, it must provide the borrower with an initial escrow account statement within sixty days of the date of transfer. When the new servicer provides an initial escrow account statement, it must use the effective date of the transfer of servicing to establish the new escrow account computation year. In addition, if the new servicer retains the monthly payments and accounting method used by the former servicer, the new servicer may continue to use the same computation year established by the former servicer or may choose a different one, using a short-year statement.

### Shortages, Surpluses, and Deficiencies Requirements (§ 3500.17(f))

The servicer must conduct an annual escrow account analysis to determine whether a surplus, shortage, or deficiency exists, as defined in section 3500.17(b).

If the escrow account analysis discloses a *surplus*, the servicer must, within thirty days from the date of the analysis, refund the surplus to the borrower if the surplus is \$50 or more. If the surplus is less than \$50, the servicer may refund such amount to the borrower or credit the amount against the next year's escrow payments. These provisions apply as long as the borrower's mortgage payment is current at the time of the analysis.

If the escrow account analysis discloses a *shortage of less than one month's escrow payments*, the servicer may do any of the following:

- Allow the shortage to exist and do nothing to change it
- Require the borrower to repay the shortage amount within thirty days
- Require the borrower to repay the shortage amount in equal monthly payments over at least a twelve-month period

If the analysis shows a *shortage more than or equal to one month's escrow payment*, the servicer may do either of the following:

- Allow the shortage to exist and do nothing to change it

- Require the borrower to repay the shortage in equal monthly payments over at least a twelve-month period

If the escrow account analysis discloses a *deficiency*, the servicer may require the borrower to pay additional monthly deposits to the account to eliminate the deficiency. If the *deficiency is less than one month's escrow account payment*, the servicer may do any of the following:

- Allow the deficiency to exist and do nothing to change it
- Require the borrower to repay the deficiency within thirty days
- Require the borrower to repay the deficiency in two or more equal monthly payments

If the *deficiency is equal to or more than one month's escrow payment*, the servicer may do either of the following:

- Allow the deficiency to exist and do nothing to change it
- Require the borrower to repay the deficiency in two or more equal monthly payments

These provisions for eliminating deficiencies and shortages apply as long as the borrower's mortgage payment is current at the time of the escrow account analysis.

A servicer must notify the borrower at least once during the escrow account computation year if a shortage or deficiency exists in the account.

### Initial Escrow Account Statement (§ 3500.17(g))

After analyzing each escrow account, a servicer must submit an initial escrow account statement to the borrower at settlement or within forty-five calendar days of settlement for escrow accounts that are established as a condition of the loan. The initial escrow account statement must include the monthly mortgage payment; the portion going to escrow; itemized estimated taxes, insurance premiums, and other charges; the anticipated disbursement dates of those charges; the amount of the cushion; and a trial running balance.

### Annual Escrow Account Statement (§ 3500.17(i))

A servicer must submit to the borrower an annual statement for each escrow account within thirty days of the completion of the computation year. The servicer must conduct an escrow account analysis before submitting the annual statement to the borrower.

The annual escrow account statement must contain an account history; a projection for the next year; the amount of the current mortgage payment and the portion going to escrow; the amount of the past year's monthly mortgage payment and the portion that went to escrow; the total amount paid into the escrow account during the past year; the amount paid from the account for taxes, insurance premiums, and other charges; the balance at the end of the period; an explanation of how the surplus, shortage, or deficiency is being handled; and, if applicable, the reasons why the estimated low monthly balance was not reached.

### Short-Year Statements (§ 3500.17(i)(4))

A short-year escrow account statement may be issued to end one escrow account computation year and establish the beginning date of the new computation year. Such a statement may be provided upon the transfer of servicing and is required upon loan payoff. The statement must be submitted to the borrower within sixty days after receipt of the payoff funds.

### Timely Payments (§ 3500.17(k))

The servicer must pay escrow disbursements by the disbursement date. In calculating the disbursement date, the servicer must use a date on or before the earlier of the deadline to take advantage of discounts, if available, or the deadline to avoid a penalty.

### Recordkeeping (§ 3500.17(l))

The servicer must keep easily retrievable records that reflect the servicer's handling of each borrower's escrow account. The records for each escrow account must be maintained for at least five years after the servicer last serviced the account.

### Penalties (§ 3500.17(m))

Failure to provide an initial or annual escrow account statement to a borrower can result in the financial institution's or servicer's being assessed a civil penalty of \$55 for each such failure, with the total for any twelve-month period not to exceed \$110,000. If the violation is due to intentional disregard, the penalty is \$110 for each failure, with no annual cap on liability.

## Mortgage Servicing Disclosures— Section 3500.21

Disclosures related to the transfer of mortgage servicing are required for first mortgage liens,

including all refinancing transactions. Subordinate-lien loans and open-end lines of credit (home equity plans) that are covered under the Truth in Lending Act and Regulation Z are exempt from this section of Regulation X.

A financial institution that receives an application for a federally related mortgage loan is required to provide the servicing disclosure statement to the borrower at the time of application if there is a face-to-face interview; otherwise, it must provide the statement within three business days after receiving the application.

When a federally related mortgage loan is assigned, sold, or transferred, the transferor (the current servicer) must provide a disclosure at least fifteen days before the effective date of the transfer. The same notice from the transferee (the new servicer) must be provided not more than fifteen days after the effective date of the transfer. Both notices may be combined in one notice if delivered to the borrower at least fifteen days before the effective date of the transfer. The disclosure must include

- The effective date of the transfer
- The name, address for consumer inquiries, and toll-free or collect-call telephone number of the transferee
- A toll-free or collect-call telephone number for an employee of the transferor who can be contacted by the borrower to answer servicing questions
- The date on which the transferor will cease accepting payments relating to the loan and the date on which the transferee will begin accepting such payments. The dates must be either the same or consecutive dates.
- Any information concerning the effect of the transfer on the terms or continued availability of mortgage life or disability insurance or any other type of optional insurance, and any action the borrower must take to maintain coverage
- A statement that the transfer does not affect the terms or conditions of the mortgage (except as related to servicing)
- A statement of the borrower's rights in connection with complaint resolution

During the sixty-day period beginning on the date of transfer, no late fee may be imposed on a borrower who has made the payment to the wrong servicer.

The following transfers are not considered an assignment, sale, or transfer of mortgage loan servicing for purposes of this requirement if there is no change in the payee, the address to which payment must be delivered, the account number, or the amount of payment due:

- Transfers between affiliates
- Transfers resulting from mergers or acquisitions of servicers or subservicers
- Transfers between master servicers, when the subservicer remains the same

### Servicers Must Respond to Borrower Inquiries (§ 3500.21(e))

A financial institution servicer must respond to a borrower's qualified written inquiry and must take appropriate action within established time frames after receiving the inquiry. Generally, the institution must provide written acknowledgment within twenty business days and must take certain specified actions within sixty business days after receiving the inquiry. The inquiry must include the name and account number of the borrower and the reasons the borrower believes the account is in error.

During the sixty-business-day period following receipt of a qualified written request from a borrower relating to a disputed payment, a financial institution may not provide information to any consumer reporting agency regarding any overdue payment relating to this period or to the qualified written request.

### Relationship to State Law (§ 3500.21(h))

Financial institutions complying with the mortgage servicing transfer disclosure requirements of RESPA

are considered to have complied with any state law or regulation requiring notice to a borrower at the time of application or transfer of a mortgage.

State laws are not affected by the act, except to the extent that they are inconsistent, and then only to the extent of the inconsistency. The Secretary of Housing and Urban Development is authorized, after consulting with the appropriate federal agencies, to determine whether such inconsistencies exist.

### Penalties and Liabilities (§ 3500.21(f))

Failure to comply with any provision of section 3500.21 of Regulation X will result in actual damages and, if there is a pattern or practice of noncompliance, any additional damages in an amount not to exceed \$1,000. In class action cases, each borrower will receive actual damages and additional damages, as the court allows, up to \$1,000 for each member of the class, except that the total amount of damages in any class action may not exceed the lesser of \$500,000 or 1 percent of the net worth of the servicer. In addition, in any successful action, the entity that failed to comply will be liable for the costs of the action and reasonable attorney's fees.



# Real Estate Settlement Procedures Act

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

1. To determine if the financial institution has established procedures to ensure compliance with RESPA
2. To determine that the financial institution does not engage in any practices prohibited by RESPA, such as kickbacks, payment or receipt of referral fees or unearned fees, or excessive escrow assessments
3. To determine if the special information booklet, good faith estimate, uniform settlement statement (form HUD-1 or HUD-1A), mortgage servicing transfer disclosures, and other required disclosures are in a form that complies with Regulation X, are properly completed, and are provided to borrowers within prescribed time periods
4. To determine if the institution is submitting the required initial and annual escrow account statements to borrowers, as applicable, and is complying with established limitations on escrow account arrangements
5. To determine whether the institution is responding to borrower inquiries for information relating to the servicing of their loans in compliance with the provisions of RESPA
  - b. The nature of services provided by referral sources, if any
  - c. The settlement service providers used by the institution
  - d. When the special information booklet is given
  - e. The timing of the good faith estimate, and how fee information is determined
  - f. Any providers whose services are required by the institution
  - g. How borrower inquiries regarding loan servicing are handled, and within what time frames
  - h. Whether escrow arrangements exist for mortgage loans

### EXAMINATION PROCEDURES

If the financial institution has loans covered by the act, determine whether the institution's policies, practices, and procedures are in compliance.

1. Review the types of loans covered by RESPA and applicable exemptions.
2. Review the special information booklet, good faith estimate (GFE) form, uniform settlement statement form (HUD-1 or HUD-1A), mortgage servicing transfer disclosure forms, and affiliated business arrangement disclosure form for compliance with the requirements of Regulation X. Review model forms in the appendixes to the regulation and after section 3500.21.
3. Review written loan policies and operating procedures in connection with federally related mortgage loans and discuss them with institution personnel.
4. Interview mortgage lending personnel to determine
  - a. The identity of persons or entities referring federally related mortgage loan business

### Special Information Booklet

6. Determine through discussion with management and review of credit files whether the special information booklet, if required, is provided within three business days after the financial institution or broker receives a written application for a loan. (§ 3500.6(a)(1))

### Good Faith Estimate

7. Determine whether the financial institution provides a good faith estimate of charges for settlement services, if required, within three business days after receipt of a written application. (§ 3500.7(a))
8. Review appendix C to Regulation X to determine if the good faith estimate appears in a similar form and contains the following required elements: (§§ 3500.7(c) and 3500.7(d))
  - a. The lender's name—If the GFE is being given by a broker, instead of the lender, the GFE must contain a legend in accordance with appendix C.
  - b. An estimate of all charges listed in section L of the HUD-1 or HUD-1A, expressed as either a dollar amount or a range—For “no cost” or “no point” loans, the charges to be shown on the GFE include payments to be made to affiliated or independent settlement service providers (shown on HUD-1 or HUD-1A as “paid outside of closing”).
  - c. An estimate of any other charge the bor-



- rower will pay based on common practice in the locality of the mortgaged property
9. Review the HUD-1 or HUD-1A prepared in connection with the lending transaction to determine if amounts shown on the GFE are reasonably similar to fees actually paid by the borrower. (§ 3500.7(c)(2)) (Note: The definition of “reasonably” is subject to interpretation by HUD.)
  10. Determine through review of the institution’s good faith estimates, HUD-1 and HUD-1A forms, and discussions with management whether the financial institution requires the borrower to use a particular individual or firm for settlement services. (§ 3500.7(e))
    - a. In cases in which the lender requires the use of a particular provider of a settlement service (except the lender’s own employees) *and* requires the borrower to pay any portion of the cost, determine if the GFE includes all of the following:
      - i. The fact that the particular provider is required
      - ii. The fact that the estimate is based on the charges of the designated provider
      - iii. The name, address, and telephone number of each provider
      - iv. The specific nature of any relationship between the provider and the lender (see section 3500.7(e)(2))
  11. If the lender maintains a list of required providers (five or more for each service) and at the time of application has not chosen the provider to be selected from the list, determine that the lender satisfies the GFE requirements by providing a written statement that the lender will require a particular provider from a lender-controlled list and by providing the range of costs for the required providers. The name and actual cost must be reflected on the HUD-1 or HUD-1A.
  - c. Charges required by the financial institution but paid outside of closing are itemized on the settlement statement and marked as “paid outside of closing” or “P.O.C.,” but are not included in totals (§ 3500.8(b); appendix A)
  13. If the financial institution conducts settlement, determine whether
    - a. The borrower, upon request, is allowed to inspect the HUD-1 or HUD-1A at least one business day before settlement (§ 3500.10(a))
    - b. The HUD-1 or HUD-1A is provided to the borrower and seller at or before settlement (§ 3500.10(b))
    - c. In cases in which the right to delivery is waived or the transaction is exempt, the statement is mailed as soon as possible after settlement (§ 3500.10(b),(c), and (d))
  14. Determine whether HUD-1 and HUD-1A forms are retained for five years. If the financial institution disposes of its interest in the mortgage and does not service the loan, the HUD-1 or HUD-1A form must be transferred with the loan file. (§ 3500.10(e))

## Mortgage Servicing Transfer Disclosure

15. Determine that the applicant received the mortgage servicing transfer disclosure at the time of application. If the application was not taken face-to-face, the disclosure must have been provided within three business days after receipt of the application. (§ 3500.21(c))
16. Determine that the disclosure states whether the loan may be assigned or transferred while it is outstanding. (§ 3500.21(b)(3))

## Notice to Borrower of Transfer of Mortgage Servicing

17. Determine whether the institution has transferred or received mortgage servicing rights.
18. If the financial institution has transferred servicing rights, determine whether notice to the borrower was given at least fifteen days prior to the transfer. (§ 3500.21(d)(2))
19. If the financial institution has received servicing rights, determine whether notice was given to the borrower within fifteen days after the transfer. (§ 3500.21(d)(2))
20. Determine whether the notices by transferor and transferee include the following information (sample language for the notice of transfer is contained in appendix B to section 3500.21(d)(3)):

## Uniform Settlement Statement Forms (HUD-1 and HUD-1A)

12. Determine if the financial institution uses the current uniform settlement statement (the HUD-1 and HUD-1A forms) as appropriate (section 3500.8 (a)) and that
  - a. Charges for both borrower and seller are properly itemized in accordance with the instructions for completion of the HUD-1 or HUD-1A (appendix A to Regulation X)
  - b. All charges paid to someone other than the lender are itemized, and the recipient is named (§ 3500.8(b); appendix A)

- a. The effective date of the transfer
- b. The name, consumer inquiry addresses (including, at the option of the servicer, a separate address to which qualified written requests must be sent), and a toll-free or collect-call telephone number for an employee or department of the transferee servicer
- c. A toll-free or collect-call telephone number for an employee or department of the transferor servicer that can be contacted by the borrower for answers to servicing transfer inquiries
- d. The date on which the current servicer will cease accepting payments and the date the new servicer will begin accepting payments relating to the transferred loan
- e. Any information concerning the effect of the transfer on the availability or terms of optional insurance, and any action the borrower must take to maintain coverage
- f. A statement that the transfer does not affect the terms or conditions of the mortgage, other than terms directly related to its servicing
- g. A statement of the borrower's rights in connection with complaint resolution (appendix MS-2 to Regulation X)

### Responsibilities of Servicer

- 21. Through a review of late notices, or otherwise if the transferor servicer received payment, determine that no late fees have been imposed and that no payments have been treated as late within sixty days following a transfer of servicing. (§ 3500.21(d)(5))
- 22. Determine that the institution, as loan servicer for mortgage loans and refinancings subject to RESPA, responds to borrower inquiries relating to these loans as prescribed in the regulation, including
  - a. Provides the notice of receipt of inquiry for qualified written correspondence from borrowers within twenty business days (unless the action requested is taken within that period and the borrower is notified in writing of that action) (§ 3500.21(e)(1))
  - b. Provides written notification of the corrections taken on the account, a statement of the reasons the account is correct, or an explanation of why the information requested is unavailable not later than sixty business days after receipt of the qualified written correspondence from the borrower (§ 3500.21(e)(3))

- c. Does not provide information to any consumer reporting agency regarding overdue payment when investigating a qualified written request from a borrower regarding disputed payments during the sixty-business-day period (§ 3500.21(e)(4)(i))

### No Fees for RESPA Disclosures

- 23. Determine whether the financial institution charges a fee specifically for preparing and distributing HUD-1 forms, escrow statements, or documents required under the Truth in Lending Act. (§ 3500.12)

### Purchase of Title Insurance

- 24. When the financial institution owns the property being sold, determine whether it requires or gives the impression that title insurance is required from a particular company. (§ 3500.16)

### Payment or Receipt of Referral or Unearned Fees

- 25. Determine if management is aware of the prohibitions against payment or receipt of kickbacks and unearned fees. (§ 3500.14)
- 26. Through interviews with institution management and personnel, file reviews, and reviews of good faith estimates and HUD-1 and HUD-1A forms, determine if federally related mortgage loan transactions are referred by brokers, affiliates, or other parties. Identify those parties. Also, identify persons or entities to which the institution refers services in connection with a federally related mortgage transaction.
  - a. Identify the types of services rendered by the broker, affiliate, or service provider.
  - b. By a review of the institution's general ledger or otherwise, determine if fees were paid to the institution or any parties identified.
  - c. Confirm that any fees paid to the broker, affiliate, service provider, or other party meet the requirements of section 3500.14(g) and are for goods or facilities actually furnished or services actually performed. These fees include payments to an affiliate or the affiliate's employees.

### Affiliated Business Arrangements

- 27. Determine from the HUD-1 or HUD-1A and from interviews with institution management if an affiliated business arrangement exists

between a referring party and any provider of settlement services. (§ 3500.15)

If such an arrangement exists, determine which providers the lender requires and that the affiliated business arrangement disclosure statement (appendix D to the regulation) was provided as required by section 3500.15(b)(1).

28. Determine whether the use of a provider of settlement services, other than an attorney, credit reporting agency, or appraiser representing the lender, was required. (§ 3500.15(b)(2))

## Escrow Accounts

If the institution maintains escrow accounts in connection with a federally related mortgage loan, complete the following procedures.

29. Determine whether the institution performed an initial escrow analysis (section 3500.17(c)(2)) and provided the initial escrow statement required by section 3500.17(g). The statement must contain the following:
- Amount of monthly payment
  - Portion of the monthly payment being placed in escrow
  - Charges to be paid from the escrow account during the first twelve months
  - Disbursement dates
  - Amount of cushion
30. Determine if the statement was given to the borrower at settlement or within forty-five days after the escrow account was established. This statement may be incorporated into the HUD-1 statement. (§ 3500.17(g)(1))
31. Determine whether the institution performs an annual analysis of the escrow account. (§§ 3500.17(c)(3), 3500.17(c)(7), and 3500.17(i))
32. Determine whether the annual escrow account statement is provided to the borrower within thirty days of the end of the computation year. (§ 3500.17(i))
33. Determine if the annual escrow statement contains the following:
- Amount of monthly mortgage payment and portion that was placed in escrow
  - Amount of past year's monthly mortgage payment and portion that went into escrow
  - Total amount paid into escrow during the past computation year
  - Total amount paid out of escrow for taxes, insurance, and other charges during the same period
  - Balance in the escrow account at the end of the period
  - How a surplus, shortage, or deficiency is to be paid or handled
  - If applicable, the reason the estimated low monthly balance was not reached
34. Determine whether monthly escrow payments following settlement are within the limits of section 3500.17(c).

# Real Estate Settlement Procedures Act Examination Checklist

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- |   |     |    |
|---|-----|----|
| 1. Are written loan policies in connection with federally related mortgage loans in compliance with Regulation X? | Yes | No |
| 2. Does the institution have established operating procedures that address the requirements of Regulation X?      | Yes | No |
| 3. Are mortgage lending personnel knowledgeable of the requirements of RESPA and Regulation X?                    | Yes | No |

## Special Information Booklet

- |   |     |    |
|---|-----|----|
| 4. For applicable transactions, is the special information booklet provided within three business days after the financial institution or broker receives or prepares a written application for a loan? | Yes | No |
|---|-----|----|

## Good Faith Estimate

- |  |     |    |
|--|-----|----|
| 5. Is a good faith estimate of charges for settlement services, if required, provided within three business days after an application is received or prepared?   | Yes | No |
| 6. Does the good faith estimate appear in a form similar to that in appendix C to Regulation X?  | Yes | No |
| 7. Does the good faith estimate (GFE) contain the following required elements?   |     |    |
| a. The lender's name or, if the GFE is being given by a broker, the legend required in accordance with appendix C to Regulation X  | Yes | No |
| b. An estimate of all charges listed in section L of the HUD-1 or HUD-1A form, expressed as either a dollar amount or a range  | Yes | No |
| c. For "no cost" or "no point" loans, payments to be made to an affiliated or independent settlement service provider (shown on the HUD-1 or HUD-1A form as "paid outside of closing")   | Yes | No |
| d. An estimate of any other charge the borrower will pay based on common practice in the locality of the mortgaged property  | Yes | No |
| 8. From a review of the HUD-1 or HUD-1A form prepared in connection with the federally related mortgage loan transaction, are amounts shown on the good faith estimate reasonably similar to the fees actually paid by the borrower?       | Yes | No |
| 9. Does the financial institution require the borrower to use a particular individual or firm for settlement services?   | Yes | No |
| a. In cases in which the lender requires the use of a particular provider of a settlement service (except the lender's own employees) <i>and</i> requires the borrower to pay any portion of the cost, does the GFE include the following? |     |    |
| i. The fact that the particular provider is required   | Yes | No |
| ii. The fact that the estimate is based on the charges of the designated provider  | Yes | No |
| iii. The name, address, and telephone number of each provider  | Yes | No |
| iv. The specific nature of any relationship between the provider and the lender  | Yes | No |

- |  |     |    |
|--|-----|----|
| <p>b. If the lender maintains a list of required providers (five or more for each service) and at the time of application has not chosen the provider to be selected from the list, does the lender satisfy the GFE requirements by providing a written statement that the lender will require a particular provider from a lender-controlled list and by providing the range of costs for the required providers?</p> | Yes | No |
| <p>10. If an affiliated business arrangement exists between a referring party and any provider of settlement services, does the lender require the services of particular providers?</p>   | Yes | No |
| <p>a. If an affiliated business arrangement exists, is the lender's only required use that of the attorney, credit bureau, or appraiser?</p>   | Yes | No |
| <p>b. Did the financial institution provide a disclosure in the format of the disclosure statement form in appendix D to Regulation X?</p>   | Yes | No |

### Uniform Settlement Statement Forms (HUD-1 and HUD-1A)

- |  |     |    |
|--|-----|----|
| <p>11. Does the financial institution use the current uniform settlement statement (HUD-1 or HUD-1A) as appropriate?</p>   | Yes | No |
| <p>12. Does the HUD-1 or HUD-1A contain the following?</p>   |     |    |
| <p>a. Charges for both borrower and seller, properly itemized in accordance with the instructions for completion of the HUD-1 or HUD-1A</p>                                  | Yes | No |
| <p>b. All charges paid to someone other than the lender, itemized, and the recipient named</p>   | Yes | No |
| <p>c. Charges required by the financial institution but paid outside of closing, itemized and marked as "paid outside of closing" or "P.O.C." but not included in totals</p> | Yes | No |
| <p>13. If the financial institution conducts settlement,</p>   |     |    |
| <p>a. Is the borrower, upon request, allowed to inspect the HUD-1 or HUD-1A at least one day prior to settlement?</p>  | Yes | No |
| <p>b. Is the HUD-1 or HUD-1A provided to the borrower and seller at settlement?</p>  | Yes | No |
| <p>c. In cases in which the right to delivery is waived or the transaction is exempt, is the statement mailed as soon as possible after settlement?</p>                      | Yes | No |
| <p>14. Are the HUD-1 and HUD-1A forms retained for five years?</p>   | Yes | No |

### Mortgage Servicing Transfer Disclosure

- |   |     |    |
|---|-----|----|
| <p>15. Does the applicant receive the mortgage servicing transfer disclosure at the time of application or, if the application was not taken face-to-face, within three business days after receipt of the application?</p> | Yes | No |
| <p>16. Does the disclosure state whether the loan may be assigned or transferred while it is outstanding?</p>   | Yes | No |

### Notice to Borrower of Transfer of Mortgage Servicing

- |   |     |    |
|---|-----|----|
| <p>17. If the institution has transferred servicing rights, was notice to the borrower given at least fifteen days prior to the transfer?</p> | Yes | No |
| <p>18. If the institution has received servicing rights, was notice given to the borrower within fifteen days after the transfer?</p>         | Yes | No |

- |   |     |    |
|---|-----|----|
| 19. Does the notice by the transferor (the current servicer) and the transferee (the new servicer) include the following information, as contained in appendix MS-2 to section 3500.21? |     |    |
| a. The effective date of the transfer   | Yes | No |
| b. The new servicer's name, address, and toll-free or collect-call telephone number   | Yes | No |
| c. A toll-free or collect-call telephone number for the current servicer to answer inquiries relating to the transfer   | Yes | No |
| d. The date on which the current servicer will cease accepting payments and the date the new servicer will begin accepting payments relating to the transferred loan                    | Yes | No |
| e. Any information concerning the effect of the transfer on the availability or terms of optional insurance, and any action the borrower must take to maintain coverage                 | Yes | No |
| f. A statement that the transfer does not affect the terms or conditions of the mortgage, other than terms directly related to its servicing  | Yes | No |
| g. A statement of the borrower's rights in connection with complaint resolution   | Yes | No |

### Responding to Borrower Inquiries

- |  |     |    |
|--|-----|----|
| 20. Have late fees been imposed within sixty days following a transfer of servicing, or were payments treated as late when received by the transferor rather than the transferee?  | Yes | No |
| 21. Does the institution respond to borrower inquiries relating to the servicing of RESPA-covered mortgage loans and refinancings as prescribed in the regulation? Specifically, does the institution  | Yes | No |
| a. Provide a written response acknowledging receipt of a qualified written request for information relating to the servicing of the loan within twenty business days?  | Yes | No |
| b. If not, was the requested action taken within the twenty-business-day period, and was the borrower notified in writing of that action?  | Yes | No |
| c. Within sixty business days after receipt of a qualified written request, does the institution make appropriate corrections in the account of the borrower and provide a written notification of the correction (including in the notice the name and telephone number of a representative of the institution who can provide assistance)? | Yes | No |
| <i>or</i>  |     |    |
| Provide the borrower with a written explanation  |     |    |
| i. Stating the reasons the account is correct (including the name and telephone number of a representative of the institution who can provide assistance) <i>or</i>  | Yes | No |
| ii. Explaining why the information requested is unavailable or cannot be obtained by the institution (including the name and telephone number of a representative of the institution who can provide assistance)   | Yes | No |
| 22. Does the institution provide information regarding an overdue payment to any consumer reporting agency during the sixty-day period beginning on the date the institution received a qualified written request relating to a dispute regarding the borrower's payments?   | Yes | No |

## Escrow Accounts

- |  |     |    |
|--|-----|----|
| 23. Does the institution perform an escrow analysis when an escrow account is established?   | Yes | No |
| 24. Is the initial escrow statement given to the borrower within forty-five days after the escrow account is established?  | Yes | No |
| 25. For continuing escrow arrangements, is an annual escrow statement provided to the borrower at least once every twelve months?  | Yes | No |
| 26. Does the initial annual escrow statement itemize the following information?  |     |    |
| a. Amount of monthly mortgage payment  | Yes | No |
| b. Portion of the monthly payment being placed in escrow   | Yes | No |
| c. Charges to be paid from the escrow account during the first twelve months   | Yes | No |
| d. Disbursement date   | Yes | No |
| e. Amount of cushion   | Yes | No |
| 27. Is the escrow statement provided within thirty days of the end of the escrow account computation year?   | Yes | No |
| 28. Does the annual escrow statement itemize the following information?  |     |    |
| a. Current payment and portion going to escrow   | Yes | No |
| b. Amount of last year's mortgage payment and portion that went to escrow  | Yes | No |
| c. Total amount paid into escrow during the past computation year  | Yes | No |
| d. Total amount paid from escrow during the year for taxes, insurance premiums, and other charges  | Yes | No |
| e. Balance in the escrow account at the end of the period  | Yes | No |
| f. Explanation of how any surplus is being handled   | Yes | No |
| g. Explanation of how any shortage or deficiency is to be paid by the borrower   | Yes | No |
| h. If applicable, the reason(s) the estimated low monthly balance was not reached  | Yes | No |
| 29. Are monthly escrow payments following settlement larger than one-twelfth of the amount expected to be paid for taxes, insurance premiums, and other charges in the following twelve months, plus one-sixth of that amount? | Yes | No |
| 30. Does the servicer notify the borrower at least annually of any shortage or deficiency in the escrow account?   | Yes | No |
| 31. Does the institution make payments from the escrow account for taxes, insurance premiums, and other charges in a timely manner as they become due?   | Yes | No |

## No Fees for RESPA Disclosures

- |   |     |    |
|---|-----|----|
| 32. Does the financial institution charge a fee specifically for preparing and distributing HUD-1 forms, escrow statements, or documents required under the Truth in Lending Act? | Yes | No |
|---|-----|----|

**Purchase of Title Insurance**

- |   |     |    |
|---|-----|----|
| 33. When the financial institution owns the property being sold, does it require or give the impression that title insurance is required from a particular company? | Yes | No |
|---|-----|----|

**Payment or Receipt of Referral or Unearned Fees**

- |  |     |    |
|--|-----|----|
| 34. Is institution management aware of the prohibitions against payment or receipt of kickbacks and unearned fees?   | Yes | No |
| 35. Are federally related mortgage loan transactions referred by brokers, affiliates, or other parties?  | Yes | No |
| <i>or</i>  |     |    |
| Does the institution refer services to brokers, affiliates, or other parties?  | Yes | No |
| 36. If fees were paid to the institution or any parties identified,  |     |    |
| a. Were all fees paid to the broker, affiliate, service provider, or other party consistent with the requirements of section 3500.14(g) and for goods or facilities actually furnished or services actually performed? | Yes | No |
| b. Were payments made to an affiliate or the affiliate's employees?  | Yes | No |





# Talent Amendment

## Limitations on Terms of Consumer Credit Extended to Service Members and Dependents

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### Background

Department of Defense (DoD) regulations implementing the consumer protection provisions of the John Warner National Defense Authorization Act for Fiscal Year 2007<sup>1</sup> contain limitations on and requirements for certain types of consumer credit extended to active duty service members and their spouses, children, and other dependents (“covered borrowers”). The regulation covers payday loans, vehicle title loans, and tax refund anticipation loans, as defined by DoD (“covered transactions”), and applies to all persons who meet the definition of creditor in Regulation Z<sup>2</sup> and are engaged in the business of extending such credit and their assignees.

For covered transactions, the DoD rule limits the amount a creditor may charge, including interest, fees, and charges imposed for credit insurance, debt cancellation and suspension, and other credit-related ancillary products sold in connection with the transaction. The total charge must be expressed as a total dollar amount and as an annualized rate referred to as the military annual percentage rate, or MAPR, which may not exceed 36 percent. The MAPR includes charges that are not included in the finance charge or the annual percentage rate disclosed under the Truth in Lending Act (TILA) and must be separately disclosed for each covered transaction. Among other provisions, the DoD rule

- Provides a safe harbor and model form for creditors to use in connection with identifying covered borrowers
- Requires creditors to provide written and oral disclosures in addition to those required by TILA
- Prohibits certain loan terms, such as prepayment penalties, mandatory arbitration clauses, and unreasonable legal notice requirements
- Restricts loan rollovers and refinancings

Creditors that knowingly violate the rule may be subject to criminal penalties, and a credit agreement that is prohibited under the rule is void from inception. The final rule took effect on October 1,

2007, and applies to covered transactions consummated on or after that date.

### Definitions (§232.3)

#### Consumer Credit

*Consumer credit* is closed-end credit offered or extended to a covered borrower primarily for personal, family, or household purposes for payday loans, vehicle title loans, and tax refund anticipation loans, as defined below.

A *payday loan* is closed-end credit

- With a term of 91 days or fewer
- For which the amount financed does not exceed \$2,000 and
- For which the covered borrower receives funds from and incurs interest and/or is charged a fee by a creditor and, contemporaneously with the receipt of funds,
  - Provides a check or other payment instrument to the creditor, who agrees not to deposit or present it for more than one day, or
  - Authorizes the creditor to initiate a debit to the borrower’s deposit account by electronic fund transfer or remotely created check after one or more days.

A *motor vehicle title loan* is closed-end credit

- With a term of 181 days or fewer
- That is secured by the title to a motor vehicle that has been registered for use on public roads and is owned by the covered borrower (other than a purchase money transaction).

A *tax refund anticipation loan* is closed-end credit for which the covered borrower expressly

- Grants the creditor the right to receive all or part of the covered borrower’s income tax refund or
- Agrees to repay the loan with the proceeds of the covered borrower’s refund.

#### Covered Borrower

A *covered borrower* is a person with the following status at the time he or she becomes obligated on a covered transaction:

- A regular or reserve member of the Army, Navy, Marine Corps, Air Force, or Coast Guard serving on active duty or under a call or order that does not specify a period of 30 days or fewer, or such a member serving on Active Guard and Reserve

1. 10 USC 987 (2006), known as the Talent Amendment.

2. 15 USC 1602(f). Among other things, Regulation Z (12 CFR 226), which implements the Truth in Lending Act, states that a creditor is one who “regularly” extends credit to consumers that is subject to a finance charge or is payable by written agreement in more than four installments and to whom the obligation is initially payable. A creditor making loans not secured by dwellings extends credit regularly if it makes more than 25 loans a year. 12 CFR 226.2(a)(17)

Duty as that term is defined in 10 USC 101(d)(6); or

- The member's spouse; child, as defined in 38 USC 101(4); or an individual for whom the member provided more than one-half of the individual's support for 180 days immediately preceding an extension of a covered transaction.

## Creditor

*Creditor* refers to all persons who meet the definition of creditor under Regulation Z and are engaged in the business of extending consumer credit covered by the rule.

Note: Instead of including assignees in the definition of "creditor," the rule specifically refers to assignees in each section of the rule that applies to an assignee.

## Military Annual Percentage Rate

The *military annual percentage rate* (MAPR) is the cost of the consumer credit transaction expressed as an annual rate. The MAPR for covered transactions may not exceed 36 percent, unless a lower limit applies.<sup>3</sup>

### *Calculation of the MAPR*

The MAPR must be calculated on the basis of the cost elements described below, but in all other respects it must be calculated and disclosed following the rules used for calculating the APR for closed-end credit under Regulation Z.

### *Cost Elements*

The MAPR includes the following cost elements

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3. The DOD rule also prohibits an institution from imposing an MAPR except as authorized by applicable state or federal law. Depending on the type of institution, different state or federal laws may govern the maximum rates and fees an institution may impose for consumer credit transactions covered by the DOD rule, but in no instance may such rates and fees exceed the 36 percent MAPR cap contained in the DOD rule.

associated with the extension of a covered transaction if the elements are financed, deducted from the proceeds of the covered transaction, or otherwise required to be paid as a condition of the credit:

- Interest, fees, credit service charges, and credit renewal charges;
- Credit insurance premiums, including charges for single-premium credit insurance, or fees for debt-cancellation or debt-suspension agreements; and
- Fees for credit-related ancillary products sold in connection with, and either at or before consummation of, the credit transaction.

The MAPR does not include

- Fees or charges imposed for actual unanticipated late payments, default, delinquency, or similar occurrence;
- Taxes or fees prescribed by law that actually are or will be paid to public officials for determining the existence of, or for perfecting, releasing, or satisfying a security interest;
- Any tax levied on security instruments or documents evidencing indebtedness if the payment of such a tax is a requirement for recording the instrument securing the evidence of indebtedness; and
- Tax return preparation fees associated with a tax refund anticipation loan, whether or not the fees are deducted from the loan proceeds.

Note: The DoD's intent is to ensure that the credit products covered by the regulation cannot evade the 36 percent limit by combining low interest rates with high fees associated with origination, membership, or administration costs or other costs that may not be captured in the TILA definition of APR. Because the MAPR includes charges that are not included in the finance charge or APR disclosed under TILA, the MAPR is required to be separately disclosed and is in addition to the APR disclosures required under TILA for covered transactions.

# Talent Amendment

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

1. Determine the institution's compliance with the provisions of 32 CFR 232, as applicable.
2. Assess the quality of the institution's compliance risk management systems and its policies and procedures for implementing the provisions.
3. Determine the reliance that can be placed on the institution's internal controls and procedures for monitoring the institution's compliance with the provisions.
4. Determine corrective action when violations of law are identified or when the institution's policies or internal controls are deficient.

### EXAMINATION PROCEDURES

#### Determine Applicability of DoD Regulations and Evaluate Policies and Procedures

1. Determine if the creditor offers or purchases<sup>4</sup> any consumer credit products covered by 32 CFR 232 (payday loans, motor vehicle title loans, and tax refund anticipation loans as defined in §232.3(b)(1)).
  - If the creditor does not offer or purchase consumer credit products as described above, the regulation does not apply and no further review is necessary.
  - If the creditor offers or purchases any consumer credit products covered by 32 CFR 232, use the procedures below to determine whether the creditor complies with the regulation.
2. Determine the extent and adequacy of the institution's policies, procedures, and practices for ensuring and monitoring compliance with the regulation.
3. Determine the extent and adequacy of the training received by individuals whose responsibilities relate to compliance with the regulation. Review any training materials pertaining to the regulation and determine whether the training is comprehensive and covers the various aspects of the provisions that apply to the creditor's offerings and operations.
4. Determine if the institution has policies or procedures in place to

- Provide account disclosure information to covered borrowers within the appropriate time frames in accordance with §232.6; and
  - Correctly calculate and limit the MAPR as defined in §232.3(h).
5. Review compliance reviews or audit material, including workpapers and reports, to determine if
    - The scope of any audits address all provisions of the regulation, as applicable;
    - Transaction testing includes samples covering relevant product types and decision centers;
    - The work performed is accurate;
    - Significant deficiencies and their causes are included in reports to management or to the board of directors;
    - Management has taken corrective actions to follow up on previously identified deficiencies; and
    - The frequency of review/audit is appropriate.
  6. Through discussions with management and review of available information, determine whether or not the institution's internal controls are adequate to ensure compliance. Consider the following:
    - Organization charts
    - Process flowcharts
    - Policies and procedures
    - Account documentation
    - Checklists
    - Computer program documentation, including any computer program testing and validation

#### Transaction-Related Procedures

When transaction testing is applicable, determine the adequacy of the institution's policies and procedures with respect to its practices. The sample size should be sufficient to cover all aspects of the institution's activities and policies subject to the regulation.

#### Identification of Covered Borrowers (§232.5)

1. For covered transactions, determine if the creditor provides the following "covered borrower identification statement" (or a substantially simi-

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4. 32 CFR 232 applies to creditors and assignees.

***Covered Borrower Identification Statement***

Federal law provides important protections to active duty members of the armed forces and their dependents. To ensure that these protections are provided to eligible applicants, we require you to sign one of the following statements as applicable:

I AM a regular or reserve member of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer.

(Signed)\_\_\_\_\_

I AM a dependent of a member of the Armed Forces on active duty as described above because I am the member's spouse, the member's child under the age of eighteen years old, or I am an individual for whom the member provided more than one-half of my financial support for 180 days immediately preceding today's date.

(Signed)\_\_\_\_\_

or

I AM NOT a regular or reserve member of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer (or a dependent of such a member).

(Signed)\_\_\_\_\_

Warning: It is important to fill out this form accurately. Knowingly making a false statement on a credit application is a crime.

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lar alternate form) to identify covered borrowers.<sup>5</sup>

*Optional Verification*—The rule provides suggestions for optional verification of the status of a covered borrower. Since these procedures are optional, examiners do not have to assess compliance with them. However, examiners should be aware that although the additional verification procedures are optional, if a creditor does use these optional procedures and determines that the borrower is a covered borrower, the creditor is subject to the rule (even if the borrower indicated on the “covered borrower” form that he or she was not a covered borrower).

The creditor may, but is not required to, verify the status of an applicant as a covered borrower

by requesting that the applicant provide

- A current military leave and earning statement, or
- A military identification card (available to both service personnel and their dependents).
- Additionally, in the case of National Guard members or reservists, a copy of the military orders and any extensions.

Alternatively, the creditor may, but is not required to, verify the status of an applicant as a covered borrower by accessing the information available through the Internet (at [www.dmdc.osd.mil/mla/owa/home](http://www.dmdc.osd.mil/mla/owa/home)) and entering the service member's full name, social security number, and date of birth.

2. If the creditor does not use the covered borrower identification statement or similar form, describe the method the creditor uses to determine compliance with the rule so that the creditor does not make covered loans to covered borrowers on prohibited terms.

**Notice and Disclosure Requirements (§232.6)**

1. Determine whether covered transaction disclo-

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5. There are limitations on use of the identification form prescribed by the regulation as a safe harbor. According to the preamble to 32 CFR 232, if the loan applicant signs a declaration of denial about being a covered borrower but the creditor obtains information as part of the credit transaction reflecting that the applicant is a covered borrower (such as a current military leave and earning statement as proof of employment), the applicant's declaration would not create a safe harbor for the creditor. In such cases, creditors should seek to resolve the inconsistency, but if they are unable to do so, they may only avoid any risk of noncompliance by treating the applicant as a covered borrower based on the documentation or by declining to extend the credit due to the inability to verify the information provided in the borrower's signed declaration. This caveat prevents creditors from using the declaration to allow covered borrowers to waive their right to the protections provided by the regulation. Refer to 32 CFR 232, 72 Fed. Reg. 50580, 50588 (August 31, 2007).

ures are made clearly and conspicuously in writing and in a form the covered borrower may keep.

2. If the covered transaction disclosures are combined with other account disclosures, determine whether it is clear which disclosures are applicable to the covered borrower's account, including those disclosures

- Related to the MAPR and the total dollar amount of all charges included in the MAPR, and
- Required by Regulation Z.

3. Determine if the disclosures reflect a clear description of the payment obligation of the covered borrower as applicable. A payment schedule provided pursuant to Regulation Z disclosure requirements will satisfy this requirement.

4. Verify that the following required statement (federal notice) is provided:

*Federal law provides important protections to regular or reserve members of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer, and their dependents. Members of the Armed Forces and their dependents may be able to obtain financial assistance from Army Emergency Relief, Navy and Marine Corps Relief Society, the Air Force Aid Society, or Coast Guard Mutual Aid. Members of the Armed Forces and their dependents may request free legal advice regarding an application for credit from a service legal assistance office or financial counseling from a consumer credit counselor.*

5. For oral disclosure, determine whether the creditor provides oral disclosure of the MAPR, the payment obligation, and required federal notice (as discussed above) before consummation.

6. In the case of mail and Internet transactions, determine whether the creditor provides

- A toll-free telephone number on or with the written disclosures that consumers may use to obtain oral disclosure, and
- Oral disclosures when the covered borrower contacts the creditor for this purpose.

7. For renewal and refinancing of covered transactions, determine if new disclosures are provided when the transaction would be considered a new transaction that would require disclosures under Regulation Z. (Refer to 12 CFR §226.20.)

Note: Creditors need not provide new disclosures unless the transaction is considered a new transaction under Regulation Z (refer to 12 CFR

§226.20). However, whether or not new disclosures are required in a particular transaction, when a creditor refinances or renews an extension of consumer credit to a covered borrower, the limitations on rates and terms apply in the same manner as they would for the original transaction.

## Prohibitions and Restrictions (§§232.4 and 232.8)

1. Determine whether the creditor, as part of any covered transaction,

- Imposed an MAPR that is not authorized by applicable state or federal law.

- Imposed an MAPR greater than 36 percent.

- Rolled over, renewed, repaid, refinanced, or consolidated any covered transaction with the proceeds of a covered transaction to the same covered borrower unless the new transaction results in more favorable terms to the covered borrower, such as a lower MAPR.

- Required the covered borrower to waive his or her right to legal recourse under any applicable provision of state or federal law, including any provision of the Servicemembers Civil Relief Act (50 USC App. §527 et seq.).

- Required the covered borrower to submit to arbitration or imposed any other onerous legal notice provision in the case of a dispute.

- Demanded unreasonable notice from the covered borrower as a condition for legal action.

- Required use of a check or other method of access to a deposit, savings, or other financial account maintained by the covered borrower, EXCEPT THAT, in a transaction with an MAPR consistent with the rule (that is, not greater than 36 percent), the creditor may

- Require an electronic fund transfer to repay the obligation, unless prohibited by Regulation E (Electronic Fund Transfers), 12 CFR 205;

- Require direct deposit of the consumer's salary as a condition of eligibility, unless otherwise prohibited by law; or

- If not otherwise prohibited by law, take a security interest in funds deposited after the extension of the covered transaction in an account established in connection with the covered transaction.

- Required the covered borrower to establish an allotment to repay the obligation.

- Prohibited the covered borrower from prepay-

ing the credit or being charged a penalty fee for prepaying all or part of the credit.

## Examination Conclusions

Conclude the examination after the following actions have been taken:

- Fully address identified deficiencies and violations, if any;

- Attach appropriate supporting workpaper documentation;
- Discuss findings with management and board of directors;
- Write comments, as applicable, in the Report of Examination;
- Include appropriate violation write-ups, as applicable; and
- Discuss proposed enforcement action, if needed.

# Talent Amendment Examination Checklist

## Defined Consumer Credit—Section 232.3

- |   |     |    |    |
|---|-----|----|----|
| 1. Does the creditor offer or extend or purchase closed-end credit primarily for personal, family, or household purposes in the following categories: |     |    |    |
| a. Payday loans,  | Yes | No | NA |
| b. Vehicle title loans, or  | Yes | No | NA |
| c. Tax refund anticipation loans.   | Yes | No | NA |
- If the answer is Yes, determine if the loans meet the definitions found in §232.3(b)(1). If the answer is Yes, proceed. If the answer is No or NA, conclude the review.

## Account Terms—Section 232.4

- |   |     |    |    |
|---|-----|----|----|
| 1. Did the creditor impose a military annual percentage rate (MAPR) that is not authorized by applicable state or federal law? (§232.4(a))    | Yes | No | NA |
| 2. Did the creditor impose an MAPR greater than 36 percent in connection with extensions of consumer credit to covered borrowers? (§232.4(b)) | Yes | No | NA |
- If the answer to either question is Yes, cite a violation of §232.4.

## Covered Borrower Identification Statement—Section 232.5

- |  |     |    |    |
|--|-----|----|----|
| 1. Prior to consummation of the consumer credit transaction,   |     |    |    |
| a. Did the creditor provide each applicant a clear and conspicuous “covered borrower identification statement” or an alternate identification form that was substantially similar?   | Yes | No | NA |
| b. Did each applicant sign the statement indicating that he or she is or is not a covered borrower? (§232.5(a)(1))   | Yes | No | NA |
| c. If the creditor did not use the “covered borrower identification statement” or similar form, did the creditor use procedures that comply with the rule so that the creditor did not make covered loans to covered borrowers on prohibited terms? (§232.4) | Yes | No | NA |

## Loan Disclosures—Section 232.6

### Delivery of Account Disclosures

- |   |     |    |    |
|---|-----|----|----|
| 1. Does the creditor provide the initial disclosures to a covered borrower clearly and conspicuously before consummation? (§232.6(a))   | Yes | No | NA |
| 2. Does the creditor provide the disclosures in writing in a form the covered borrower can keep? (§232.6(b)(1))   | Yes | No | NA |
| 3. Does the creditor provide the initial disclosures orally before consummation (other than in mail or Internet transactions)? (§232.6(b)(2))   | Yes | No | NA |
| 4. For mail or Internet transactions, does the creditor provide a toll-free number on or with the written disclosures? (§232.6(b)(2))   | Yes | No | NA |
| 5. For refinancing or renewal of a covered loan, does the creditor provide new disclosures when the transaction would be considered a new transaction that requires disclosures under the Truth in Lending Act? (§232.6(c)) | Yes | No | NA |



## Content of Disclosures

### 6. Do the disclosures include

- |   |     |    |    |
|---|-----|----|----|
| a. The "military annual percentage rate" (MAPR) applicable to the extension of consumer credit, and the total dollar amount of all charges included in the MAPR? (§232.6(a)(1)) | Yes | No | NA |
| b. Any disclosures required by Regulation Z (Truth in Lending)? (§232.6(a)(2))  | Yes | No | NA |
| c. A clear description of the payment obligation of the covered borrower, as applicable, such as a payment schedule? (§232.6(a)(3))   | Yes | No | NA |
| d. The required federal notice? (§232.6(a)(4))  | Yes | No | NA |

## Limitations—Section 232.8

### 1. Does the creditor, as part of any covered transaction,

- |   |     |    |    |
|---|-----|----|----|
| a. Roll over, renew, repay, refinance, or consolidate any covered transaction with the proceeds of a covered transaction to the same covered borrower on the same or less-favorable terms, unless the new transaction results in more-favorable terms? (§232.8(a)(1)) | Yes | No | NA |
| b. Require the covered borrower to waive his or her right to legal recourse under any applicable provision of state or federal law, including any provision of the Servicemembers Civil Relief Act (50 USC 527 et seq.)? (§232.8(a)(2))                               | Yes | No | NA |
| c. Require the covered borrower to submit to arbitration or impose any other onerous legal notice provision in the case of a dispute? (§232.8(a)(3))  | Yes | No | NA |
| d. Demand unreasonable notice from the covered borrower as a condition for legal action? (§232.8(a)(4))   | Yes | No | NA |
| e. Require use of a check or other method of access to a deposit, savings, or other financial account maintained by the covered borrower except that in connection with a transaction with an MAPR consistent with the rule (that is, not greater than 36%)?          | Yes | No | NA |
| 1. The creditor may require an electronic fund transfer to repay the obligation, unless prohibited by Regulation E (12 CFR 205);  | Yes | No | NA |
| 2. May require direct deposit of the consumer's salary as a condition of eligibility, unless otherwise prohibited by law; or  | Yes | No | NA |
| 3. May, if not otherwise prohibited by law, take a security interest in funds deposited after the extension of the covered transaction in an account established in connection with the covered transaction. (§232.8(a)(5))   | Yes | No | NA |
| f. Require the covered borrower to establish an allotment to repay the obligation? (§232.8(a)(6))   | Yes | No | NA |
| g. Prohibit the covered borrower from prepaying the credit or charge the covered borrower a penalty fee for prepaying all or part of the credit? (§232.8(a)(7))   | Yes | No | NA |

# Servicemembers Civil Relief Act (SCRA) of 2003

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## Background

The Servicemembers Civil Relief Act (SCRA) of 2003 was signed into law on December 19, 2003, amending and replacing the Soldiers' and Sailors' Civil Relief Act of 1940, and is codified at 50 U.S.C. App. 501 *et seq.* It was further amended December 10, 2004, by the Veterans Benefits Improvement Act of 2004. The law protects members of the Army, Navy, Air Force, Marine Corps, and Coast Guard, including members of the National Guard, as they enter military service (active duty<sup>1</sup>), as well as commissioned officers of the Public Health Service and the National Oceanic and Atmospheric Administration engaged in active service. Some of the benefits accorded to servicemembers by the SCRA also extend to servicemembers' spouses, dependents, and other persons subject to the obligations of servicemembers. The Housing and Economic Recovery Act of 2008 (HERA) recently amended several sections of this law, extending the time period for certain activities. Major relief provisions of the SCRA include the following:

## Maximum Rate of Interest on Loans, Including Mortgages

- Upon receiving a written request for relief and a copy of the servicemember's military orders, creditors must, for the duration of the servicemember's military service, reduce the interest<sup>2</sup> rate on debts<sup>3</sup> incurred by the servicemember, or

a servicemember and spouse jointly, prior to entry into military service to no more than 6 percent per year. (This applies to the individual servicemember's debt or joint debt with a spouse.)

- Creditors must maintain the interest rate reduction for the period of military service, except in the case of a mortgage, trust deed, or other security in the nature of a mortgage, where the interest rate reduction extends for one year after the end of the servicemember's military service.<sup>4</sup>
- Creditors who reduce the interest rate on the obligations of a servicemember must forgive interest in excess of 6 percent.
- The reduced interest rate provision applies unless a court finds the ability of the servicemember to pay interest on the debt at a higher interest rate is not materially affected by his or her military service. In such cases, the court may grant a creditor relief from the interest rate limitations of the Act.

## Residential and Motor Vehicle Purchases and Leases

- Contracts for the purchase of real or personal property, for which the servicemember has paid a deposit or made a payment before the servicemember enters military service, may not be rescinded or terminated after the servicemember's entry into military service for a breach of the terms of the contract occurring before or during their military service, or the property repossessed because of the breach without a court order.
- Termination of certain residential or motor vehicle leases may be made at the option of the lessee servicemember if the servicemember provides to the lessor or the lessor's agent written notice of the request for termination along with a copy of the military orders.
  - Automobiles leased for personal or business use by the servicemember or their dependent may be terminated if the servicemember, after the lease is executed, enters military service

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1. In the case of servicemembers who are members of the Army, Navy, Air Force, Marine Corps, or Coast Guard, active duty is defined as "full-time duty in the active military service of the United States. Such term includes full-time training duty, annual training duty, and attendance, while in the active military service, at a school designated as a service school by law or by the Secretary of the military department concerned. Such term does not include full-time National Guard duty." 10 USC § 101(d). Note the term "military service" under the SCRA also includes National Guard members under a call of duty authorized by the President or the Secretary of Defense for more than 30 consecutive days and servicemembers who are commissioned officers of the Public Health Service and the National Oceanic and Atmospheric Administration engaged in "active service." 50 U.S.C. app. 511(2)(B).

2. "Interest" is defined in the SCRA to include service and renewal charges or any other fees or charges, except for charges for bona fide insurance. 50 U.S.C. app. 527(d).

3. Section 207 of the SCRA, 50 U.S.C. app. 527, applies to "an obligation or liability . . . incurred by the servicemember, or the servicemember and the servicemember's spouse jointly, before the servicemember enters military service." No distinction is made between personal versus business credit. However, according to a U.S. Department of Education memorandum, the SCRA limitation on interest rates does not apply to federally insured student loans based on 20 U.S.C. § 1078(d), which states that no provision of any Federal or state law that limits the interest rate on a loan, will apply to loans made under a government student loan program. Nonetheless, the other provisions of the SCRA, including those providing for a stay of proceedings and reopening

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default judgments, remain available to servicemembers.

4. The extension of the interest rate reduction for mortgages for an additional one year period after the end of military service was added by Section 2203(b) of HERA, which was signed into law on July 30, 2008. Section 2203(a) of HERA extends the stay, adjustment, sale, foreclosure, and seizure provisions from 90 days to 9 months following the end of the servicemember's period of military service. Unlike Section 2203(b), the amendment described in Section 2203(a) expires on December 31, 2010. On January 1, 2011, the SCRA will revert to the provisions in effect before the date of enactment.

for a period of 180 days or more.

- Additionally, an automobile lease entered into while the servicemember is on active duty may be terminated if the servicemember receives military orders for a permanent change of station (PCS) outside of the continental United States (this would include a PCS to Hawaii or Alaska) or deployment for a period of 180 days or more.
- Termination of an automobile lease also includes the return of the automobile to the lessor within 15 days after delivery of the written notice of termination.
- Termination is permitted of pre-service “residential, professional, agricultural, or similar” leases occupied or intended to be occupied by a servicemember or a dependent as well as those leases executed during military service where the servicemember subsequently receives orders for a PCS or a deployment for a period of 90 days or more.

### Foreclosure, Eviction from Bank-Owned Property

- Real or personal property owned by a servicemember before the servicemember’s military service that secures a mortgage, trust deed, or similar security interest cannot be sold, foreclosed upon, or seized based on a breach of such a secured obligation during the period of military service or 9 months thereafter without a court order. Additionally, in an action filed during or within 9 months after a servicemember’s military service, a court may, after a hearing on its own, or shall, upon application by a servicemember, stay a proceeding to enforce an obligation as described above or adjust the debt, when the member’s ability to comply with the obligation is materially affected by reason of the member’s military service.<sup>5</sup>
- A landlord may not evict a servicemember or the dependent of a servicemember from premises that are occupied or intended to be occupied as a primary residence during a period of military service except by court order.<sup>6</sup>

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5. Section 303 of the SCRA, 50 U.S.C. app. 533, as amended by Section 2203(a) of HERA.

6. The law as originally passed by Congress applied to only those dwellings with monthly rents of \$2,400 or less. Accordingly, evictions involving residences with monthly rents of \$2,400 or less require a court order. This amount is adjusted yearly and is published in the *Federal Register* by the Department of Defense. The figure as of January 1, 2009, is \$2,932.31. This annual

### Life Insurance Assigned as Security

- If a life insurance policy on the life of a servicemember is assigned before military service to secure the payment of an obligation, the assignee of the policy (except the insurer in connection with a policy loan) may not exercise, during the period of the servicemember’s military service or within one year thereafter, any right or option obtained under the assignment, absent compliance with a court order or other specified requirement.

### Adverse Action

- The fact that a servicemember applies for or receives a stay, postponement, or suspension of his or her obligations or liabilities pursuant to the SCRA may not in itself provide the basis for the following:
  - A determination by a lender or other person that the servicemember is unable to pay the obligation or liability in accordance with its terms;
  - A creditor’s denial or revocation of credit, change in terms of an existing credit arrangement, or refusal to grant credit to the servicemember in substantially the amount or on substantially the terms requested;
  - An adverse report relating to the creditworthiness of the servicemember by or to a consumer reporting agency;
  - A refusal by an insurer to insure the servicemember;
  - An annotation in a servicemember’s record by a creditor or a person engaged in the practice of assembling or evaluating consumer credit information identifying the servicemember as a member of the National Guard or a reserve component; or,
  - A change in the terms offered or conditions required for the issuance of insurance.

### Relief for Other Obligors

- Whenever a court grants a stay, postponement, or suspension to a servicemember on an obligation, it may likewise grant a person primarily or secondarily liable such a stay, postponement, or suspension.

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adjustment is generally announced in February.

# Servicemembers Civil Relief Act (SCRA) of 2003

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

1. Determine the institution's compliance with the provisions of the SCRA, as applicable, to the institution's product offering and operations, including management of other real estate owned, where a servicemember or his/her dependents may be tenants.
2. Assess the quality of the institution's compliance risk management systems and its policies and procedures for implementing the SCRA.
3. Determine the reliance that can be placed on the institution's internal controls and procedures for monitoring the institution's compliance with the SCRA.
4. Determine corrective action when violations of law are identified, or when the institution's policies or internal controls are deficient.
  - The work performed is accurate;
  - Significant deficiencies and their causes are included in reports to management or to the Board of Directors;
  - Management has taken corrective actions to follow-up on previously identified deficiencies; and,
  - The frequency of review/audit is appropriate.
4. If any complaints based on the SCRA have been filed against the institution, determine:
  - Why they were filed; and,
  - How they were resolved.
5. If the institution has received any actual requests for relief under the SCRA, determine whether appropriately trained staff reviewed the requests and if appropriate records are maintained.

### EXAMINATION PROCEDURES

#### General

1. Through discussions with management and review of available information, determine whether the institution's internal controls are adequate to ensure compliance with the SCRA. Consider:
    - Policies and procedures;
    - Account documentation;
    - Checklists; and,
    - Computer program documentation, including any computer program testing and validation.
  2. Determine the extent and adequacy of the training received by individuals whose responsibilities relate to compliance with the regulation. Review any training materials pertaining to the Act and determine whether the training is comprehensive and covers the various aspects of the provisions that apply to the creditor's offerings and operations.
  3. Review compliance reviews or audit materials, including work papers and reports, to determine if:
    - The scope of any audits address all provisions of the SCRA, as applicable;
    - Transaction testing includes samples covering relevant product types and decision centers (for example, both mortgage and credit card processing centers);
- #### Interest Rate Reduction for Loans, Including Mortgages
6. Determine how the institution handles requests for interest rate reductions under the SCRA on an obligation incurred by a servicemember or by a servicemember and spouse jointly, before the servicemember entered military service.
  7. Determine how the institution calculates the reduced interest rate. Does the institution include all service and renewal charges, as well as other fees and charges, with the exception of charges for bona fide insurance?
  8. Determine whether the institution applies the interest rate reduction effective as of the date the servicemember was called to military service.
  9. Determine whether the institution applies the interest rate reduction throughout the term of the servicemember's military service, for all credit products. In the case of a mortgage, the institution must continue to apply the interest rate reduction for a one year period following the termination of military service.
- #### Residential and Motor Vehicle Leases
10. Determine, in the case of a residential lease entered into before the servicemember entered into military service or executed by the servicemember while in military service but who subsequently receives orders for a permanent change of station or for a deployment of at least 90 days, that the institution permits the service-

member to terminate the lease.

11. Determine if the institution permits the servicemember to terminate a motor vehicle lease where:
  - The motor vehicle lease is for personal or business use by the servicemember or his/her dependent; and,
    - The lease is executed by the servicemember before he/she enters military service for a period of 180 days or more, or,
    - The servicemember, while in military service, executes the lease and subsequently receives military orders for a PCS outside of the continental United States (this includes a PCS to Hawaii or Alaska), or deployment with a military unit for a period of 180 days or more.

### Foreclosure, Eviction from Bank-Owned Property

12. Determine, in the case of an institution acting as a landlord, that the institution does not evict a servicemember or his/her dependents<sup>7</sup> from a residence covered by the Act occupied primarily as a residence during a period of military service except by court order.
13. Determine that in the case of real or personal property owned by a servicemember before the servicemember's military service which is secured by a mortgage, trust deed, or similar security interest, the institution obtains a court order before initiating the sale, foreclosure, or seizure based on a breach of such secured obligation during the period of military service or nine months thereafter.

### Installment Contracts

14. Determine, in the case of an institution that finances or purchases installment contracts for the purchase of real or personal property, that where a servicemember has paid a deposit or made a payment before entering military service, that the contract was not rescinded or terminated by the institution after the servicemember's entry into service, absent a court order for a breach of the terms of the contract occurring before or during the military service, or the property repossessed because of the breach.

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<sup>7</sup> Dependents are defined in the SCRA as: (a) the servicemember's spouse; (b) the servicemember's child; or, (c) an individual for whom the servicemember provided more than one-half of the individual's support for 180 days preceding an application for relief under the SCRA.

### Insurance Assigned as Security for a Loan

15. Determine, in the case of an insurance policy on the life of a servicemember that is assigned before the servicemember's military service as security for an obligation, that the institution does not exercise, during a period of military service or within one year thereafter, any right or option obtained under the assignment, absent a court order. This prohibition does not apply:
  - If the assignee has written consent of the insured servicemember, obtained during his/her military service;
  - When the premiums on the policy are due and unpaid; or,
  - Upon the death of the insured.

### Adverse Action

16. Determine, in the case of an application from or receipt by a servicemember of a stay, postponement, or suspension of an obligation, that the institution does not use such action as a basis of:
  - A determination that the lender is unable to pay the obligation or liability in accordance with its terms;
  - Denial or revocation of credit, change in terms of an existing credit, or refusal by the creditor to grant credit to the servicemember in substantially the same amount or terms; or,
  - An adverse credit report or reference.

### Examination Conclusions

17. Conclude the examination after taking the following actions:
  - Fully address identified deficiencies and violations, if any;
  - Attach appropriate supporting work-paper documentation;
  - Discuss findings with management and board of directors;
  - Write comments, as applicable, in the Report of Examination;
  - Include appropriate violation write-ups; and,
  - Discuss proposed enforcement action, if needed.

### Applicable Laws and Regulations

- Servicemembers Civil Relief Act, Pub. L. 108-189 (codified at 50 U.S.C. App. 501 *et seq.*)

- Veterans Benefits Improvement Act of 2004, Pub. L. 108-454
- Housing and Economic Recovery Act of 2008,
- U.S.C. § 1078(d), Federal payments to reduce student interest costs



# Servicemembers Civil Relief Act (SCRA) of 2003 Examination Checklist

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## Section 518—Exercise of Rights Under Act Not to Affect Certain Future Financial Transactions

1. Does the creditor refrain from taking adverse action against a servicemember solely because the servicemember exercised rights under the Act? (50 U.S.C. App. §518)
- |  |     |    |    |
|--|-----|----|----|
|  | Yes | No | NA |
|--|-----|----|----|

If No, cite a violation of Section 518.

## Section 527—Maximum Rate of Interest on Debts Incurred Before Military Service

1. Did the creditor reduce the interest rate on obligations of a servicemember, or of a servicemember jointly with the servicemember's spouse, incurred prior to military service, to no more than 6 percent during the period of military service upon receipt of written notice and a copy of the servicemember's military orders? (527(a)(1))
- |  |     |    |    |
|--|-----|----|----|
|  | Yes | No | NA |
|--|-----|----|----|

Note that in the case of a mortgage, the 6 percent cap extends to one year following the end of military service. Interest under the SCRA includes all service, renewal or other charges and fees with the exception of bona fide insurance charges.

If No, cite a violation of Section 527(a)(1).

2. Did the creditor forgive interest in excess of 6 percent? (527(a)(2))
- |  |     |    |    |
|--|-----|----|----|
|  | Yes | No | NA |
|--|-----|----|----|

If No, cite a violation of Section 527(a)(2).

3. Did the creditor reduce any periodic payment due by the servicemember by the amount of the interest forgiven? (527(a)(3))
- |  |     |    |    |
|--|-----|----|----|
|  | Yes | No | NA |
|--|-----|----|----|

If No, cite a violation of Section 527(a)(3).

4. Upon receipt of the written notice from the servicemember and a copy of the military orders, did the creditor apply the interest rate reduction retroactively to the date on which the servicemember is called to military service? (527(b)(2))
- |  |     |    |    |
|--|-----|----|----|
|  | Yes | No | NA |
|--|-----|----|----|

If No, cite a violation of Section 527(b)(2).

## Section 532—Protection Under Installment Contracts For Purchase or Lease

1. Did the creditor obtain a court order before rescinding or terminating contracts by a servicemember for the purchase, lease, or bailment of real or personal property (including a motor vehicle) for any breach of terms occurring before or during military service, provided a deposit or installment had been paid prior to entry into military service? Similarly, did the creditor obtain a court order before repossessing property due to breach of terms? (532(a))
- |  |     |    |    |
|--|-----|----|----|
|  | Yes | No | NA |
|--|-----|----|----|

If No, cite a violation of Section 532(a).

## Section 533—Mortgages and Trust Deeds

1. Did the creditor obtain a court order before selling, foreclosing, or seizing real or personal property due to a breach of an obligation by a servicemember during the period of military service or within 9 months after without a court order? (533(c))
- |  |     |    |    |
|--|-----|----|----|
|  | Yes | No | NA |
|--|-----|----|----|

Note that HERA sunsets the 9 months extension on December 31, 2010, and the SCRA reverts to the original statutory provision of 90 days.

If No, cite a violation of Section 533(c).



### **Section 535—Termination of Residential or Motor Vehicle Lease**

- |  |     |    |    |
|--|-----|----|----|
| 1. Did the creditor terminate the lease within the stipulated timeframe once the requirements for termination were met by the servicemember lessee? (535(d)) | Yes | No | NA |
|--|-----|----|----|

If No, cite a violation of Section 535(d).

- |  |     |    |    |
|--|-----|----|----|
| 2. Did the creditor refund the lease amounts paid in advance for a period after the effective date of termination within 30 days of the effective date of the termination of the lease? (535(e)) | Yes | No | NA |
|--|-----|----|----|

If No, cite a violation of Section 535(e).

### **Section 536—Protection of Life Insurance Policy**

- |   |     |    |    |
|---|-----|----|----|
| 1. Did the creditor obtain a court order before exercising any right or option obtained under an assignment of the servicemember's life insurance policy made before the servicemember's military service, during the period of military service, or within one year thereafter? (536(a)) | Yes | No | NA |
|---|-----|----|----|

If No, cite a violation of Section 536(a).

# Regulation G

## Disclosure and Reporting of CRA-Related Agreements (CRA Sunshine Requirements)

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### Background

Regulation G, Disclosure and Reporting of CRA-Related Agreements, implements the CRA Sunshine Requirements, which were added to the Federal Deposit Insurance Act (FDI Act), as section 48, by section 711 of the Gramm–Leach–Bliley Act (GLBA). The CRA Sunshine Requirements require nongovernmental entities and persons (NGEPs), insured depository institutions (IDIs), and affiliates of insured depository institutions that are parties to certain agreements that are in fulfillment of the Community Reinvestment Act (CRA) to make the agreements available to the public and the appropriate federal banking agency, and to file annual reports concerning the agreements with the appropriate agency. The Sunshine Requirements—and the interagency regulations implementing them (including the Board’s Regulation G)—do not affect the Community Reinvestment Act of 1977, its implementing regulations, or the agencies’ interpretations or administration of that act or those regulations.

Regulation G identifies the types of written agreements that are covered by the statute (referred to as covered agreements), defines many of the terms used in the statute, describes how the parties to a covered agreement must make the agreement available to the public and to the appropriate agencies, and explains the type of information that must be included in the annual report filed by a party to a covered agreement. However, neither GLBA nor Regulation G gives the Federal Reserve any authority to enforce the provisions of any covered agreement.

Regulation G became effective in April 2001. As described in the regulation (and outlined in the tables at the end of this chapter summarizing the requirements), the disclosure requirements apply to covered agreements entered into after November 12, 1999. The annual reporting requirements apply to covered agreements entered into on or after May 12, 2000.

### Applicability

The CRA Sunshine Requirements of Regulation G apply to

- State member banks and their subsidiaries
- Bank holding companies

- Affiliates of bank holding companies, other than banks, savings associations, and subsidiaries of banks and savings associations
- Nongovernmental entities or persons that enter into covered agreements with any entity listed above

### Definitions

Selected terms used in Regulation G are defined below; other terms, including “affiliate” and “term of agreement,” are defined in section 207.11 of the regulation.

### Covered Agreement

A *covered agreement* is any contract, arrangement, or understanding that meets all of the following criteria:

- The agreement is in writing.
- The parties to the agreement include
  - One or more insured depository institutions or affiliates of an insured depository institution and
  - One or more NGEPs.
- The agreement provides for the insured depository institution or any affiliate to
  - Provide to one or more individuals or entities (whether or not parties to the agreement) cash payments, grants, or other considerations (except loans) that have an aggregate value of more than \$10,000 in any calendar year or
  - Make to one or more individuals or entities (whether or not parties to the agreement) loans that have an aggregate principal amount of more than \$50,000 in any calendar year.
- The agreement is made pursuant to, or in connection with, the fulfillment of the CRA.
- The agreement is with a NGEP that has had a CRA communication prior to entering into the agreement.

A covered agreement does not include

- Any individual loan that is secured by real estate
- Any specific contract or commitment for a loan or extension of credit to an individual, business, farm, or other entity, or group of such individuals or entities, if

- The funds are loaned at rates that are not substantially below market rates and
- The loan application or other loan documentation does not indicate that the borrower intends or is authorized to use the borrowed funds to make a loan or extension of credit to one or more third parties.

### CRA Affiliate

A *CRA affiliate* of an insured depository institution is any company that is an affiliate of an insured depository institution to the extent, and only to the extent, that the activities of the affiliate were considered by the appropriate federal banking agency when evaluating the CRA performance of the institution at its CRA examination prior to the agreement. An insured depository institution or affiliate also may designate any company as a CRA affiliate at any time prior to the time a covered agreement is entered into, by informing the NGEF that is a party to the agreement of such designation.

### CRA Communications

A *CRA communication* is any of the following that meets the timing and knowledge requirements of section 207.3(b) of Regulation G:

- Any written or oral comment or testimony provided to a federal banking agency concerning the adequacy of the CRA performance of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate
- Any written comment submitted to the insured depository institution that discusses the adequacy of its CRA performance and must be included in the institution's CRA public file
- Any discussion or other contact with the insured depository institution or any affiliate about
  - Providing (or refraining from providing) written or oral comments or testimony to any federal banking agency concerning the adequacy of the CRA performance of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate,
  - Providing (or refraining from providing) written comments to the insured depository institution that concern the adequacy of the institution's CRA performance and must be included in the institution's CRA public file, or
  - The adequacy of the CRA performance of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate

Examples of actions that are CRA communications can be found in section 207.3(c)(1), and examples of actions that are not CRA communications can be found in section 207.3(c)(2).

### Fulfillment of the CRA

Factors that are in fulfillment of the CRA:

- *Comments to a federal banking agency or included in the CRA public file*—Providing or refraining from providing written or oral comments or testimony to any federal banking agency concerning the performance under the CRA of an insured depository institution or CRA affiliate that is a party to the agreement or an affiliate of a party to the agreement, or written comments that are required to be included in the CRA public file of any such insured depository institution, or
- *Activities given favorable CRA consideration*—Performing any of the following activities if the activity is of the type that is likely to receive favorable consideration by a federal banking agency in evaluating the performance under the CRA of the insured depository institution that is a party to the agreement or of an affiliate of a party to the agreement:
  - Engaging in home purchase, home improvement, small business, small farm, community development, and consumer lending, as described in section 228.22 of Regulation BB, which implements the CRA, including purchasing loans, making loan commitments, and extending letters of credit
  - Making investments, deposits, or grants or acquiring membership shares that have as their primary purpose community development, as described in section 228.23 of Regulation BB
  - Delivering retail banking services, as described in section 228.24(d) of Regulation BB
  - Providing community development services, as described in section 228.24(e) of Regulation BB
  - In the case of a wholesale or limited purpose insured depository institution, engaging in community development lending, including originating and purchasing loans, making loan commitments, extending letters of credit, making qualified investments, and providing community development services, as described in section 228.25(c) of Regulation BB
  - In the case of a small insured depository institution, engaging in any lending or other activity described in section 228.26(a) of Regulation BB
  - In the case of an insured depository institution that is evaluated on the basis of a strategic plan, fulfilling any element of the strategic plan, as described in section 228.27 of Regulation BB

## Insured Depository Institution

*Insured depository institution* means any bank or savings association whose deposits are insured by the FDIC. The definition includes any uninsured branch or agency of a foreign bank or a commercial lending company owned or controlled by a foreign bank for purposes of section 8 of the FDI Act.

## Nongovernmental Entity or Person

A *nongovernmental entity or person (NGEP)* is any partnership, association, trust, joint venture, joint stock company, corporation, limited liability corporation, company, firm, society, other organization, or individual.

An NGEP does not include

- The U.S. government, a state government, a unit of local government (including a county, city, town, township, parish, village, or other general-purpose subdivision of a state), or an Indian tribe or tribal organization established under federal, state, or Indian tribal law (including the Department of Hawaiian Home Lands); or a department, agency, or instrumentality of any such entity
- A federally chartered public corporation that receives federal funds appropriated specifically for that corporation
- An insured depository institution or affiliate of an insured depository institution
- An officer, director, employee, or representative (acting in his or her capacity as an officer, director, employee, or representative) of the above-mentioned entities

## Relevant Supervisory Agency

The *relevant supervisory agency* for a covered agreement means the appropriate federal banking agency for

- Each insured depository institution (or subsidiary thereof) that is a party to the covered agreement
- Each insured depository institution (or subsidiary thereof) or CRA affiliate that makes payments or loans or provides services that are subject to the covered agreement
- Any company (other than an insured depository institution or subsidiary thereof) that is a party to the covered agreement



# Regulation G

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

To determine whether the institution

- Is aware of its responsibilities under section 48 of the FDI Act and the implementing CRA Sunshine Regulation (Regulation G)
- Has identified any written agreements that would trigger the section 48 requirements
- Discloses covered agreements and files annual reports as required by the regulation

### EXAMINATION PROCEDURES

1. Determine whether the institution can appropriately identify any written contract, arrangement, or understanding covered under Regulation G.
2. With regard to covered agreements that the institution has identified, determine whether the institution discloses covered agreements to the public and the relevant supervisory agency in a timely manner and files annual reports relating to covered agreements in a timely manner.
3. Require appropriate corrective action.
4. Document findings.



# Regulation G

## Summary of Disclosure and Reporting Requirements

### A. Disclosure of Covered Agreements to the Public

Requirement	Nongovernmental Entities and Persons	Insured Depository Institutions (IDIs) and Affiliates
Which agreements must be disclosed to the public?	Covered agreements entered into after 11/12/99	Covered agreements entered into after 11/12/99
When does my duty to disclose a covered agreement to the public begin?	4/1/01	4/1/01
What event triggers my obligation to disclose a covered agreement to a member of the public?	An individual or entity must request that you make a covered agreement available.	An individual or entity must request that you make a covered agreement available.
How do I disclose a covered agreement to the public?	You must promptly make a copy of the covered agreement available. You may withhold information that is confidential and proprietary under FOIA standards. However, you must disclose certain enumerated items of information identified in section 207.6(b)(3) of Regulation G.	You must promptly make a copy of the covered agreement available. You may withhold information that is confidential and proprietary under FOIA standards. However, you must disclose certain enumerated items of information identified in section 207.6(b)(3) of Regulation G.  An IDI or affiliate may make an agreement available by placing a copy of the covered agreement in the IDI's CRA public file. The IDI must make the agreement available in accordance with the CRA rule on public files.
When does my duty to disclose a covered agreement to the public end?	Twelve months after the end of the term of the agreement. However, if your agreement terminated before 4/1/01, your obligation to disclose terminates 4/1/02.	Twelve months after the end of the term of the agreement. However, if your agreement terminated before 4/1/01, your obligation to disclose terminates 4/1/02.



## B. Disclosure of Covered Agreements to the Relevant Supervisory Agency (RSA)

Requirement	Nongovernmental Entities and Persons	Insured Depository Institutions (IDIs) and Affiliates
What agreements must be disclosed to the RSA?	Covered agreements entered into after 11/12/99	Covered agreements entered into after 11/12/99
When does my duty to disclose a covered agreement to the RSA begin?	4/1/01	4/1/01
When must I disclose a covered agreement to the RSA?	You must disclose your covered agreement to the RSA within 30 days after the RSA requests a copy of the agreement.	You must disclose your covered agreement to the RSA within 60 days of the end of the calendar quarter after the agreement is entered into.
How do I disclose a covered agreement to the RSA?	You must provide the RSA with a complete copy of the agreement. If you propose the withholding of any information that may be withheld from disclosure under FOIA, you must also provide a public version of the agreement that excludes such information and an explanation justifying the exclusion. The public version must include certain information. See section 207.6(b)(3) of Regulation G.	You must provide the RSA with a complete copy of the agreement. If you propose the withholding of any information that may be withheld from disclosure under FOIA, you must also provide a public version of the agreement that excludes such information and an explanation justifying the exclusion. The public version must include certain information. See section 207.6(b)(3) of Regulation G.  Alternatively, you may provide a list of all covered agreements that you entered into during the calendar quarter and include the information described in section 207.6(d)(1). If the RSA requests a copy of an agreement referenced in the list, you must provide a copy of the agreement and a public version (if applicable) within 7 calendar days.
When does my duty to disclose a covered agreement to the RSA end?	Twelve months after the end of the term of the agreement.	If you provide a list, your obligation to provide a copy of an agreement referenced in the list terminates 36 months after the end of the term of the agreement.

### C. Filing of Annual Reports with the Relevant Supervisory Agency (RSA)

Requirement	Nongovernmental Entities and Persons (NGEPs)	Insured Depository Institutions (IDIs) and Affiliates
What agreements are subject to the requirements for annual reporting to the RSA?	Covered agreements entered into on or after 5/12/00	Covered agreements entered into on or after 5/12/00
What periods require an annual report?	You must report for each fiscal year in which you receive or use funds or other resources under the covered agreement. Alternatively, you may file your report on a calendar year basis.	You must report for each fiscal year in which you have any reportable data concerning the covered agreement described in section 207.7(e)(1)(iii), (e)(1)(iv), or (e)(1)(vi). Alternatively, you may file your report on a calendar year basis.
When must I file the annual report?	For fiscal years that end after 1/1/01, you must file the report with each RSA within 6 months after the end of the fiscal year covered by the report.  Alternatively, you may, within this 6-month period, provide the report to an IDI or affiliate that is a party to the agreement. You must include written instructions requiring the IDI or affiliate to promptly forward the report to the RSA(s).	For fiscal years that end after 1/1/01, you must file the report with each RSA within 6 months after the end of the fiscal year covered by the report.  If an NGEP has provided its report to you, you must also file that report with the RSA(s) on behalf of the NGEP within 30 days of receipt.
May I file a consolidated annual report?	If you are a party to two or more covered agreements, you may file a single consolidated annual report concerning all the covered agreements.	If you are a party to two or more covered agreements, you may file a single consolidated annual report concerning all the covered agreements.  If you and your affiliates are parties to the same covered agreement, you may file a single consolidated annual report relating to the agreement.
What must I include in the annual report?	You must include the information described in section 207.7(d) of Regulation G.	You must include the information described in section 207.7(e) of Regulation G.



# Regulation H

## Section 109 of the Riegle–Neal Interstate Banking and Branching Efficiency Act

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### Background

The Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act) allows banks to branch across state lines. Section 109 of the act, however, prohibits a bank from establishing or acquiring a branch or branches outside its home state, pursuant to the act, primarily for the purpose of deposit production. Congress enacted section 109 to ensure that interstate branches would not take deposits from a community without the bank’s reasonably helping to meet the credit needs of that community. Interagency regulations implementing section 109 became effective in October 1997. The Board’s rules implementing the provision for state member banks are located in section 208.7 of Regulation H, Membership of State Banking Institutions in the Federal Reserve System.

Section 106 of the Gramm–Leach–Bliley Act of 1999 (GLBA) expanded the coverage of section 109 by changing the definition of an “interstate branch.” As a result, section 109 also applies to any bank or branch of a bank controlled by an out-of-state bank holding company. Interagency regulations implementing this amendment became effective October 1, 2002.

The language of section 109 and its legislative history make clear that section 109 is to be administered without imposing additional regulatory burden on banks. Consequently, the Board’s regulation does not impose additional data-reporting requirements or require banks to produce, or assist in producing, relevant data.

### Coverage

Section 109 applies to any bank that has covered interstate branches. (Examples of covered interstate branches follow the examination checklist at the end of this chapter.)

### Definitions

#### Covered Interstate Branch

*A covered interstate branch is*

- Any branch of a bank; any federal branch of a foreign bank; and any uninsured or insured branch of a foreign bank licensed by a state that
  - Is established or acquired outside the bank’s home state pursuant to the interstate branching authority granted by the Interstate Act or

by any amendment made by the Interstate Act to any other provision of law or

- Could not have been established or acquired outside the bank’s home state but for the establishment or acquisition of a branch described immediately above and
- Any bank or branch of a bank controlled by an out-of-state bank holding company.

#### Home State

*Home state* is defined as follows:

- For state banks, the state that chartered the bank
- For national banks, the state in which the main office of the bank is located
- For bank holding companies, the state in which the total deposits of all banking subsidiaries of the company are the largest on the later of
  - July 1, 1966, or
  - The date on which the company becomes a holding company under the Bank Holding Company Act
- For foreign banks,
  - For purposes of determining whether a U.S. branch of a foreign bank is a covered interstate branch, the home state of the foreign bank as determined in accordance with 12 USC 3103(c) and section 211.22 of the Board’s regulations (12 CFR 211.22) and
  - For purposes of determining whether a branch of a U.S. bank controlled by a foreign bank is a covered interstate branch, the state in which the total deposits of all banking subsidiaries of the foreign bank are the largest on the later of
    - July 1, 1966, or
    - The date on which the foreign bank becomes a bank holding company under the Bank Holding Company Act

#### Host State

*Host state* means a state in which a covered interstate branch is established or acquired.

#### Host State Loan-to-Deposit Ratio

The *host state loan-to-deposit ratio* relates to all banks that have that state as their home state and

is the ratio of those banks' total loans in the host state to their total deposits from the host state.

### Out-of-State Bank Holding Company

An *out-of-state bank holding company* is, with respect to any state, a bank holding company whose home state is another state.

### Statewide Loan-to-Deposit Ratio

The *statewide loan-to-deposit ratio* relates to an individual bank and is the ratio of the bank's loans to its deposits in a particular state in which it has one or more covered interstate branches.

### The Two-Step Test

Beginning no earlier than one year after a covered interstate branch is acquired by or established as a state member bank, the Board must determine whether a bank is complying with the provisions of section 109. Section 109 provides a two-step test for determining compliance with the prohibition against interstate deposit-production offices:

1. *Compare loan-to-deposit ratios*—The first step is to conduct a loan-to-deposit (LTD) ratio test to measure the lending and deposit activities of a bank's covered interstate branches and then compare the bank's statewide LTD ratio with the host state LTD ratio. If the bank's statewide LTD ratio is at least one-half of the relevant host state LTD ratio, the bank passes the section 109 evaluation and no further review is required. Host state ratios are prepared annually by the Board and are made public in press releases available on the Board's public web site under the title "Banking agencies issue host state loan-to-deposit ratios."
2. *Determine whether the bank is meeting credit needs*—The second step, necessary if a bank fails the LTD ratio test or the LTD ratio cannot be calculated because data are not sufficient or are not reasonably available, is to determine whether the bank is reasonably helping to meet the credit needs of the communities served by the bank in the host state. This step requires the examiner to review the activities of the bank, such as its lending activity and its performance under the CRA. Banks may provide the examiner with any relevant information, including loan data, if a credit-needs determination is conducted.

Although section 109 specifically requires the examiner to consider a bank's CRA rating when making a credit-needs determination, the bank's CRA rating should not be the only factor considered. However, it is expected that banks rated

"satisfactory" or better on CRA will receive a favorable credit-needs determination. Banks rated lower than "satisfactory" on CRA may receive an adverse credit-needs determination unless circumstances are mitigated by the other factors enumerated in section 109. To ensure consistency, a bank's compliance with section 109 generally should be reviewed in conjunction with the evaluation of its CRA performance.

For institutions designated as wholesale or limited purpose banks, the credit-needs determination should consider the bank's performance using the appropriate CRA performance test provided in the CRA regulations. For banks not subject to CRA, including certain special-purpose banks and uninsured branches of foreign banks,<sup>1</sup> the CRA regulations should be used only as a guideline when making a credit-needs determination. Section 109 does not obligate such banks to have a record of performance under the CRA or require them to pass any CRA performance tests.

### Enforcement and Sanctions

Before a bank may be sanctioned under section 109, the examiner must demonstrate that the bank failed the LTD ratio test *and* failed to reasonably help meet the credit needs of the communities in the host state served by the bank. Because the bank must fail both the LTD ratio test and the credit-needs determination to be in non-compliance with section 109, the examiner has an obligation to apply the LTD ratio test before seeking sanctions, regardless of the regulatory burden imposed. Thus, if a bank receives an adverse credit-needs determination, the LTD ratio test must be applied even if the data necessary to calculate the appropriate ratio are not readily available. Consequently, the examiner is required to obtain the necessary data to calculate the bank's statewide LTD ratio before sanctions are imposed.

If a bank fails both steps of the section 109 evaluation, sanctions may be imposed, as specified in the statute:

- Ordering the closing of the interstate branch in the host state and
- Prohibiting the bank from opening a new branch in the host state

Sanctions may not be warranted, however, if the bank provides reasonable assurances, to the satisfaction of the Board, that it has an acceptable

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1. A special-purpose bank that does not provide commercial or retail banking services by granting credit to the public in the ordinary course of business is not evaluated for CRA performance. Likewise, a branch of a foreign bank, unless the branch is insured or resulted from an acquisition as described in the International Banking Act, 12 USC 3101 et seq., is not evaluated for CRA performance.

plan that will reasonably help meet the credit needs of the communities served, or to be served. Federal Reserve examiners should consult with Reserve Bank management and the Board before discuss-

ing possible sanctions with any bank. Before sanctions are imposed, the Reserve Bank should also consult with state banking authorities.



# Regulation H—Section 109

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

- To ensure that a bank is not operating a covered interstate branch, as defined, primarily for the purpose of deposit production, by determining if the bank meets
  - The loan-to-deposit (LTD) ratio test or
  - The credit-needs determination requirements of section 109 of the Interstate Act

### EXAMINATION PROCEDURES

(Examples of covered interstate branches follow the examination checklist at the end of this chapter.)

#### A. Identification of Covered Interstate Branches

1. Banks controlled by an out-of-state bank holding company
  - (a) Determine if the bank is controlled by an out-of-state bank holding company by identifying the home state of the bank and the home state of the bank holding company. To determine the home state of a bank, refer to the definition. To determine the home state of a bank holding company, refer to home state data available from the Board and confirm the home state with bank management.
  - (b) If the bank is not controlled by a bank holding company, or if the home state of the bank holding company is the same state as the home state of the bank, the bank does not have any covered interstate branches under examination procedure 1. Go to procedure 2.
  - (c) If the home state of the bank holding company is not the same as the home state of the bank, the bank meets the definition of a covered interstate branch and is subject to section 109. Go to procedures 2 and 3.
2. Banks with interstate branches

Determine if the bank has any branches that were established or acquired pursuant to the Interstate Act in states other than the bank's home state. If it does, the bank has a covered interstate branch. Go to procedure 3. If the bank has no covered interstate branches under procedures 1 and 2, the bank is not subject to section 109, and no further review is necessary.

#### 3. One-year rule

For the covered interstate branches identified in procedure 1 or 2, determine if any have been covered interstate branches for one year or more. Note that if any of a bank's covered interstate branches within a particular state have been covered interstate branches for one year or more, then all of the bank's covered interstate branches within that state are subject to review. If any branch has been a covered interstate branch for one year or more, go to procedure 4. If not, no further review is necessary at this time.

#### B. Assessment of Compliance with the LTD Ratio Test

4. For a covered interstate branch subject to section 109, determine if the bank has sufficient data to calculate a statewide LTD ratio for each host state. (The bank is not required to provide this information or to assist in providing this information.) For states for which the bank has sufficient data, go to procedure 5. For states for which the bank does not have sufficient data, go to procedure 6.
5. For each host state for which the bank can provide loan and deposit data, calculate and compare the bank's statewide LTD ratio with the applicable host state LTD ratio provided by the Board. If the bank's statewide LTD ratio is one-half or greater than one-half of the relevant host state LTD ratio, the bank passes the LTD ratio test and the section 109 evaluation in that state, and no further review is necessary. If the bank's statewide LTD ratio is less than one-half of the host state LTD ratio in that state, the bank fails the LTD ratio test. Go to procedure 6.

#### C. Credit-Needs Determination

6. For each host state identified in procedure 4 or 5, determine whether the bank is reasonably helping to meet the credit needs of communities served by the bank in the host state. When making this determination, consider all of the following:
  - (a) Whether the covered interstate branches were formerly part of a failed or failing depository institution
  - (b) Whether the covered interstate branches were acquired under circumstances in which there was a low LTD ratio because of the



nature of the acquired institution's business or loan portfolio

- (c) Whether the covered interstate branches have a higher concentration of commercial or credit card lending, trust services, or other specialized activities, including the extent to which the covered interstate branches accept deposits in the host state
- (d) The most recent ratings (overall rating, multistate MSA rating, and state ratings) received by the bank under the Community Reinvestment Act (CRA)
- (e) Economic conditions, including the level of loan demand, within the communities served by the covered interstate branches
- (f) The safe and sound operation and condition of the bank
- (g) The CRA regulation, examination procedures, and interpretations of the regulation

If the bank passes the credit-needs determination test, it is in compliance with section 109, and no further review is necessary. If the bank fails the credit-needs determination test but a LTD ratio test has not been conducted, go to procedure 7. If the bank

fails the credit-needs determination test and has failed the LTD ratio test, the bank is in noncompliance with section 109. Go to procedure 8.

#### **D. Determination of Whether Sanctions Are Warranted**

- 7. Calculate the bank's statewide LTD ratio for each host state in which the bank failed the credit-needs determination test. The data used to calculate these ratios may be obtained from any reliable source. The bank may, but is not required to, provide the examiner with additional data at any time during the examination. If the bank's statewide LTD ratio(s) is one-half of or greater than one-half of the host state LTD ratio, the bank is in compliance with section 109 requirements, and no further review is necessary. If the bank's statewide LTD ratio is less than one-half of the host state LTD ratio, the bank is not in compliance with section 109. Go to procedure 8.
- 8. Consult with Reserve Bank management and the Board to determine whether sanctions are warranted.

# Regulation H–Section 109 Examination Checklist

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## Identify Covered Interstate Branches Subject to Section 109 Evaluation

1. Does the bank have any covered interstate branches? Determine
- (a) If the bank has established or acquired any branches outside the bank's home state pursuant to the interstate branching authority granted by the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 or
- Yes      No
- (b) Whether the bank, including a bank consisting of only a main office, is controlled by an out-of-state bank holding company as defined in section 2(o)(7) of the Bank Holding Company Act of 1956
- Yes      No
- Note: If the answer to both (a) and (b) is “no,” no further review is necessary.
2. Have any covered interstate branches been covered interstate branches for one year or more? If any of a bank's covered interstate branches within a particular state have been covered interstate branches for one year or more, all the bank's covered interstate branches within that state are subject to review.
- Yes      No
- Note: If the answer is “no,” no further review is necessary.

## Assess Compliance with the Loan-to-Deposit (LTD) Ratio Test

3. For covered interstate branches subject to section 109, does the bank have sufficient data to calculate a statewide LTD ratio(s) for each respective host state?
- Yes      No
- Note: For each host state for which the answer is “no,” proceed to checklist item 5.
4. For each host state in which a covered interstate branch exists, calculate the bank's statewide LTD ratio. Is the statewide LTD ratio equal to or greater than one-half of the host state LTD ratio?
- Yes      No
- Note: For each host state for which the answer is “yes,” the bank is in compliance with section 109, and no further review is necessary. For each host state for which the answer is “no,” proceed to checklist item 5.

## Perform Credit-Needs Determination Test

5. For each host state identified in checklist item 3 or 4, is the bank reasonably helping to meet the credit needs of the communities served by the bank in the host state?
- Yes      No
- When making this determination, consider the following:
- Whether the covered interstate branches were formerly part of a failed or failing depository institution
  - Whether the covered interstate branches were acquired under circumstances in which there was a low LTD ratio because of the nature of the acquired institution's business or loan portfolio
  - Whether the covered interstate branches have a higher concentration of commercial or credit card lending, trust services, or other specialized activities, including the extent to which the covered interstate branches accept deposits in the host state

- The most recent ratings (overall rating, multistate MSA rating, and state ratings) received by the bank under the Community Reinvestment Act (CRA)
- Economic conditions, including the level of loan demand, within the communities served by the covered interstate branches
- The safe and sound operation and condition of the bank
- The CRA regulation, examination procedures, and interpretations

Note: If the bank passes the credit-needs determination test, the bank complies with section 109, and no further review is necessary. If the bank fails the credit-needs determination test but the LTD ratio test has not yet been conducted, go to checklist item 6. If the bank fails the credit-needs determination test and has failed the LTD ratio test, go to item 7.

### Determine if Sanctions Are Warranted

6. Calculate the statewide LTD ratio for each host state for which the bank failed the credit-needs determination test. Is this ratio equal to or greater than one-half of the host state LTD ratio?

Yes      No

Note: If the answer is “yes,” the bank is in compliance with section 109, and no further review is necessary. If the answer is “no,” the bank is in noncompliance with section 109 (go to checklist item 7).

7. After consultation with Reserve Bank management and the Board, are sanctions warranted?

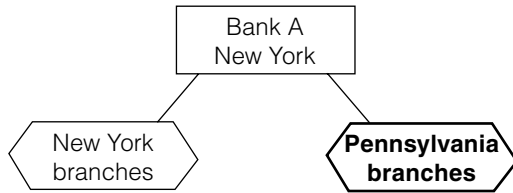
Yes      No

# Regulation H—Section 109

## Examples of Covered Interstate Branches

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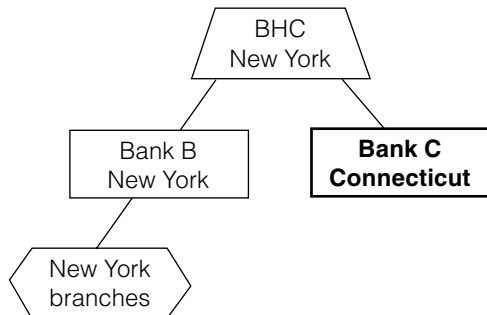
### Bank with Branches outside Its Home State



Bank A is an interstate bank with branches in Pennsylvania that were established or acquired under the Interstate Act. Bank A's home state is New York and its host state is Pennsylvania. The Pennsylvania branches are covered interstate branches subject to the section 109 review. Bank A's statewide loan-to-deposit (LTD) ratio in Pennsylvania is compared with the host state LTD ratio for Pennsylvania.

The section 109 test is conducted at the same time the bank's CRA examination is conducted.

### Bank Consisting of Only a Main Office and Controlled by an Out-of-State Bank Holding Company



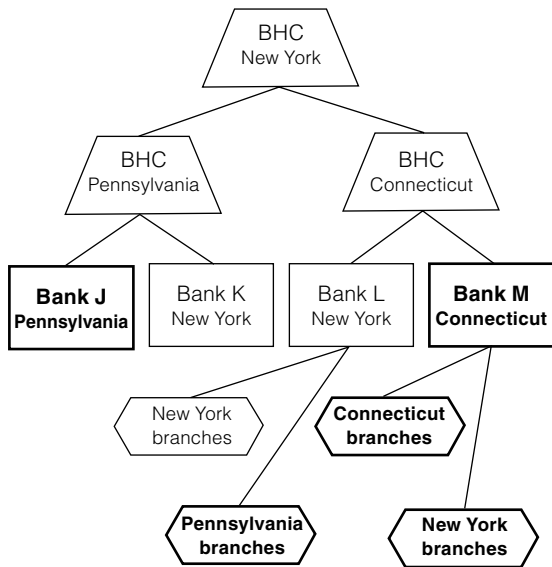
Banks B and C are controlled by a bank holding company whose home state is New York. Bank B is an intrastate bank and is not subject to the section 109 review.

Bank C's home state is Connecticut; it is subject to the section 109 review because it is controlled by an out-of-state bank holding company whose home state is New York. Bank C's statewide LTD ratio in Connecticut is compared with the host state LTD ratio for Connecticut.

The section 109 test is conducted at the same time the bank's CRA examination is conducted.

Note: Bold type indicates that the bank or branch is subject to the section 109 review.

## Covered Interstate Branches under a Multitiered Bank Holding Company Structure



Note: Bold type indicates that the bank or branch is subject to the section 109 review.

This example illustrates the need to look to the top-tier bank holding company when determining whether to conduct the section 109 review. Banks J, K, L, and M are controlled by a top-tier holding company whose home state is New York.

### Out-of-state bank holding company

Banks J and M are subject to section 109 reviews because an out-of-state top-tier bank holding company controls both of them. Bank J's home state is Pennsylvania; its statewide LTD ratio in Pennsylvania is compared with the host state LTD ratio for Pennsylvania. Bank M's home state is Connecticut; its statewide LTD ratio in Connecticut is compared with the host state LTD ratio for Connecticut.

### Out-of-state branches

Bank M's branches in New York also are subject to the section 109 review, because Bank M is an interstate bank. Bank M's home state is Connecticut; its statewide LTD ratio in New York is compared with the host state LTD ratio for New York.

Bank L's branches in Pennsylvania also are subject to the section 109 review because Bank L is an interstate bank. Bank L's home state is New York; its statewide LTD ratio in Pennsylvania is compared with the host state LTD ratio for Pennsylvania.

### Not subject to 109 review

Bank K is not subject to review for section 109 compliance because an out-of-state bank holding company does not control it and it does not have interstate branches.

The section 109 test is conducted at the same time the bank's CRA examination is conducted.

# Regulation M

## Consumer Leasing

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### Background

Regulation M, Consumer Leasing, implements the Consumer Leasing Act (15 USC 1667 et seq.), which was enacted in 1976. A major purpose of the act is to ensure that consumers receive meaningful and accurate disclosure of the terms of a lease before entering into a contract to lease personal property. Such disclosure is intended to help consumers compare one lease with another, as well as compare the cost of leasing with the cost of buying on credit or the opportunity cost of paying cash. The act also sets limits on balloon payments sometimes due at the end of a lease and regulates advertising.

The Consumer Leasing Act, which is part of the Truth in Lending Act, was originally implemented by Regulation Z, Truth in Lending. When Regulation Z was revised in 1981, the provisions of the regulation governing consumer leases were moved to Regulation M. In 2007, Regulation M was updated to incorporate guidance on the electronic delivery of disclosures consistent with the E-Sign Act.<sup>1</sup>

Today, a relatively small number of banks engage in consumer leasing. The trend seems to be for leasing to be carried out through specialized bank subsidiaries, vehicle finance companies, other finance companies, or directly by retailers.

### Key Definitions

Understanding certain key terms plays an integral role in understanding the requirements imposed by the Consumer Leasing Act.

#### Lessee

A *lessee* is a natural person who enters into or is offered a consumer lease.

#### Lessor

A *lessor* is a natural person or organization who regularly leases, offers to lease, or arranges for the lease of personal property under a consumer lease. A person who leased or offered to lease more than five times in the preceding calendar year or the current calendar year meets this definition.

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1. The Electronic Signatures in Global and National Commerce Act, 15 USC 7001 et seq.

### Consumer Lease

A *consumer lease* is a lease contract between a lessor and a lessee

- For the use of personal property by an individual (natural person)
- For personal property to be used primarily for personal, family, or household purposes
- For a period of more than four months (week-to-week and month-to-month leases do not meet this criterion, even though they may be extended beyond four months) and with a total contractual cost of no more than \$25,000

Specifically *excluded* from coverage by Regulation M are leases

- For business, agricultural, or commercial purposes or made to an organization
- For real property
- For personal property incidental to the lease of real property, subject to certain conditions
- For credit sales, as defined in Regulation Z, section 226.2(a)(16)

A lease meeting all the criteria for a consumer lease is covered by the Consumer Leasing Act and Regulation M. If any one of the criteria is not met, for example, if the leased property is to be used primarily for business purposes or the total contractual cost exceeds \$25,000, the act and the regulation do not apply.

Consumer leases fall into one of two categories: closed-end and open-end. The information that must be disclosed to consumers varies according to the category of lease, so it is important to note the differences between the categories. To understand the differences, one must first understand “realized value” and “residual value.”

#### Realized Value

The *realized value* is (1) the price received by the lessor of the leased property at disposition, (2) the highest offer for disposition of the leased property, or (3) the fair market value of the leased property at the end of the lease term.

#### Residual Value

The *residual value* is the value of the leased property at the end of the lease, as estimated or assigned by the lessor at consummation of the lease.

## Open-End Lease

An *open-end lease* is a lease in which the amount owed at the end of the lease term is based on the difference between the residual value and the realized value of the leased property. If the realized value is less than the residual value, the consumer may have to pay all or part of the difference; if the realized value is greater than the residual value, the consumer may receive a refund.

## Closed-End Lease

A *closed-end lease* is any lease other than an open-end lease. This type of lease allows the consumer to “walk away” at the end of the contract period with no further payment obligation—unless the property has been damaged or has sustained abnormal wear and tear.

## Gross Capitalized Cost

The *gross capitalized cost* is the amount agreed upon by the lessor and lessee as the value of the leased property, plus any items that are capitalized or amortized during the lease term, such as taxes, insurance, service agreements, and any outstanding prior credit or lease balance.

## Capitalized Cost Reduction

The *capitalized cost reduction* is the total amount of any rebate, cash payment, net trade-in allowance, and noncash credit that reduces the gross capitalized cost.

## Adjusted Capitalized Cost

The *adjusted capitalized cost* is the gross capitalized cost less the capitalized cost reduction. It is the amount used by the lessor in calculating the base periodic payment.

## General Disclosure Requirements

### Format of Disclosures

Lessors are required to provide the consumer with leasing cost information and other disclosures in a format similar to the model disclosure forms in appendix A to Regulation M. Certain pieces of this information must be kept together and must be segregated from other lease information. All the information stated must be accurate, clear and conspicuous, and provided in writing in a form that the consumer may keep.

With the consumer’s consent, Regulation M disclosures may be provided electronically. Before consent can be given, consumers must be provided with a clear and conspicuous statement,

informing the consumer of

- Any right or option to have the information provided in paper or non-electronic form;
- The right to withdraw the consent to receive information electronically and the consequences, including fees, of doing so;
- The scope of the consent (for example, whether the consent applies only to a particular transaction or to identified categories of records that may be provided during the course of the parties’ relationship);
- The procedures to withdraw consent and to update information needed to contact the consumer electronically; and
- The methods by which a consumer may obtain, upon request, a paper copy of an electronic record after consent has been given to receive the information electronically and whether any fee will be charged.

The consumer must consent electronically or confirm consent electronically in a manner that “reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent.”

If an institution makes subsequent changes to the hardware or software requirements that would prevent a consumer from accessing and retaining information electronically, the institution must notify the consumer of the new requirements and must allow the consumer to withdraw consent without charge.

## Content of Disclosures

Disclosure requirements are outlined in section 213.4 of the regulation. Briefly, leasing disclosures must contain the following information, as applicable:

- Description of the leased property
- Amount due at lease signing or delivery
- Payment schedule and total amount of periodic payments
- Other charges
- Total of payments
- Payment calculation
- Early-termination information
- Maintenance responsibilities
- Purchase option
- Statement referencing nonsegregated disclosures
- Liability resulting from a difference between the

residual value and the realized value

- Right of appraisal
- Liability at the end of the lease term based on the residual value
- Fees and taxes
- Insurance
- Warranties or guarantees
- Penalties and other charges for delinquency
- Security interest
- Limitations on rate information
- Additional disclosures for non-motor-vehicle open-end leases

### Timing of Disclosures

A dated disclosure statement must be given to the consumer before the lease is signed. The disclosure must contain all the information detailed in section 213.4 of the regulation.

### Renegotiations and Extensions

New disclosures must generally be provided when a consumer renegotiates or extends a lease beyond six months.

### Multiple Lessors and Lessees

In the event of multiple lessors, one lessor may make the required disclosures on behalf of all the lessors. If the lease involves more than one lessee, the required disclosures may be given to any lessee who is primarily liable.

### Advertising

Advertisements concerning consumer leases must also comply with certain disclosure requirements. All advertisements must be accurate. If a printed ad includes any reference to certain triggering terms—the amount of any payment or a statement of a capitalized cost reduction (that is, a down payment) or other payment required before or at lease signing or delivery (or that no such payment is required)—the ad must also state the following:

- That the transaction is a lease
- The total amount due prior to or at lease signing or delivery
- The number, amounts, and due dates or periods of the scheduled payments
- Whether or not a security deposit is required

Advertisements for open-end leases must also include a statement that extra charges may be

imposed at the end of the lease based on the difference between the residual value and the realized value at the end of the lease term.

If a percentage rate is given in an advertisement, the rate must not be more prominent than any of the other required disclosures, with the exception of the notice described in section 213.4(s). Such an ad must also include the statement, “This percentage may not measure the overall cost of financing this lease.” The term “annual percentage rate” or “annual lease rate,” or any equivalent term, may not be used.

Some fees (license, registration, taxes, and inspection fees) may vary by state or locality. An advertisement may exclude these third-party fees from the disclosure of a periodic payment or a total amount due at lease signing or delivery, provided that the ad states that these fees have been excluded. Otherwise, an ad may include these fees in the periodic payment or total amount due, provided that it states that the fees are based on a particular state or locality and indicates that the fees may vary.

Disclosures for electronic advertisements (such as an advertisement on an Internet website) may be provided in the advertisement without regard to the consumer consent or other provision of the E-Sign Act. As with a catalog or multi-page advertisement, an electronic advertisement that includes a table or schedule of the required disclosures is considered a single advertisement if, for the lease terms that appear without all the required disclosures, the advertisement clearly refers the consumer to the location where the additional required information begins. For example, a term triggering additional disclosures may be accompanied by a link that directly connects the consumer to the additional disclosures.

### Limits on Balloon Payments

To limit balloon payments that may be required of the consumer, certain sections of the regulation call for reasonable calculations and estimates. These provisions protect the consumer at early termination of a lease, at the end of the lease term, or in the event of delinquency, default, or late-payment status. They limit the lessee’s liability at the end of the lease term and set reasonableness standards for wear and use charges, early-termination charges, and penalties or fees for delinquency.

### Penalties and Liability

Criminal and civil liability provisions of the Truth in Lending Act also apply to the Consumer Leasing Act. Actions alleging failure to disclose the required information or to otherwise comply with the Con-



sumer Leasing Act must be brought within one year of the termination of the lease agreement.

### **Record Retention**

Lessors are required to maintain evidence of

compliance with the requirements of Regulation M, other than the advertising requirements under section 213.7, for a period of at least two years after the date the disclosures are required to be made or an action is required to be taken.

# Regulation M

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

1. To assess the quality of the financial institution's compliance management system for the Consumer Leasing Act
2. To determine that lessees of personal property are given meaningful and accurate disclosures of lease terms
3. To determine if the limits of liability are clearly indicated to lessees and are correctly enforced by the institution
4. To ensure that the institution provides accurate disclosures of its leasing terms in all advertising

### EXAMINATION PROCEDURES

#### General Disclosure Requirements

- A. Review the institution's procedures for providing disclosures to ensure that it has adequate controls and procedures to effect compliance.
- B. Review the disclosures provided by the institution.
  1. Are the disclosures clear and conspicuous and provided in writing in a form the consumer can keep?
    - a. For disclosures provided electronically (other than for advertising requirements), are the disclosures in electronic form provided in compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act)?<sup>2</sup>
    - b. For an advertisement accessed by the consumer in electronic form, are the disclosures required by 12 CFR 213.7 provided to the consumer in electronic form in the advertisement? (§ 213.3(a))
  2. Are the disclosures given in a dated statement and in the prescribed format? (§ 213.3(a)(1))
  3. Is the information required by sections 213.4(b) through (f), (g)(2), (h)(3), (i)(1), (j), and (m)(1) segregated and in a form substantially similar to the model in appendix A to Regulation M? (§ 213.3(a)(2))

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2. The final amendments to Regulation M on the electronic delivery of disclosures, consistent with the requirements of the E-Sign Act, became effective December 10, 2007, and require mandatory compliance by October 1, 2008.

4. Are the disclosures timely? (§ 213.3(a)(3))
5. If the lease involves more than one lessee, are the disclosures provided to any lessee who is primarily liable? (§ 213.3(c))
6. If additional information is provided, is it provided in a manner such that it does not mislead or confuse the lessee? (§ 213.3(b))
7. Are all estimates clearly identified and reasonable? (§ 213.3(d))
8. Are the disclosures accurate, and do they contain the information required by sections 213.4(a)–213.4(t)?
9. Are disclosures given to lessees when they renegotiate or extend their leases? (§ 213.5)

#### Lessee Liability

Review the lease estimates and calculations to ensure that no unreasonable balloon payment is expected of the lessee in the following circumstances:

- A. At early termination
  1. Does the lessor disclose the conditions under which the lease may be terminated early and the amount, and method of determining the amount, of any early-termination charges? (§ 213.4(g)(1))
  2. Are any early-termination charges reasonable? (§ 213.4(g)(1))
- B. At end of lease term (for wear and use)
  1. If the lessor sets standards for wear and use of the leased vehicle, are the amounts of, or method of determining the amounts of, any charge for excess mileage disclosed? (§ 213.4(h)(3))
  2. Are standards for wear and use reasonable? (§ 213.4(h)(2))
- C. At end of lease term (for open-end leases)
  1. Does the lessor disclose the limitations on the lessee's liabilities at the end of the lease term? (§ 213.4(m)(2))
  2. Are the lessee and lessor permitted to make a mutually agreeable final adjustment regarding excess liability? (§ 213.4(m)(3))
- D. In the event of delinquency, default, or late payment
  1. Does the lessor disclose penalties or other charges for delinquency, default, or late

payments? (§ 213.4(q))

2. Are the penalties or other charges reasonable? (§ 213.4(q))

## Advertising

- A. Review advertising policies and procedures used by the institution to ensure that it has adequate controls and procedures to effect compliance.
- B. Review a sample of the institution's advertisements.
  1. Do the advertisements contain terms that are usually and customarily available? (§ 213.7(a))
  2. Are the disclosures contained in the advertisements clear and conspicuous? (§ 213.7(b))
  3. Do catalog or multiple-page advertisements comply with the page-reference requirements? (§ 213.7(c))

4. When triggering terms are used, do the advertisements contain the additional required information? (§ 213.7(d))

Do merchandise tags that use triggering terms refer to a sign or display that contains the additional required disclosures? (§ 213.7(e))

5. If television or radio advertisements that use triggering terms do not contain the additional terms required by section 213.7(d)(2), do they use alternative disclosure methods (that is, do they direct consumers to a toll-free number or a written advertisement)? (§ 213.7(f))

## Miscellaneous

1. Are records and other evidence of compliance retained for at least two years? (§ 213.8)

# Regulation M Examination Checklist

1. Does the institution engage in consumer leasing or purchase consumer leases from lessors? (§ 213.2(h)) (If it does not, there is no need to complete this checklist.)	Yes	No
2. Are the disclosures made prior to consummation of the lease (that is, at the time a binding order is made or the lease is signed)? (§ 213.3(a)(3))	Yes	No
3. Are the disclosures clear and conspicuous and provided in writing in a form the consumer can keep? (§ 213.3(a))	Yes	No
4. Are disclosures in electronic form provided in compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act)? (§ 213.3(a))	Yes	No
5. For an advertisement accessed by the consumer in electronic form, are the disclosures required by 12 CFR 213.7 provided to the consumer in electronic form in the advertisement? (§ 213.3(a))	Yes	No
6. Are the disclosures given in a dated statement and made in either (i) a separate statement that identifies the consumer lease transaction, (ii) the contract, or (iii) other document evidencing the lease? (§ 213.3(a)(1))	Yes	No
7. Is the information required by sections 213.4(b)–(f), (g)(2), (h)(3), (i)(1), (j), and (m)(1) segregated and in a form substantially similar to the model in appendix A to Regulation M? (§ 213.3(a)(2))	Yes	No
8. If the lease involves more than one lessee, are the disclosures provided to any lessee who is primarily liable? (§ 213.3(c))	Yes	No
9. If additional information is provided, is it provided in a manner such that it does not mislead or confuse the lessee? (§ 213.3(b))	Yes	No
10. Are disclosures provided to at least one lessee when there are multiple lessees and by at least one lessor when there are multiple lessors? (§ 213.3(c))	Yes	No
11. Are all estimates clearly identified and reasonable? (§ 213.3(d))	Yes	No
12. Are the following disclosures made in the lease?		
A. Description of property (§ 213.4(a))	Yes	No
B. Amount due at lease signing or delivery (§ 213.4(b))	Yes	No
C. Payment schedule and total amount of periodic payments (§ 213.4(c))	Yes	No
D. Other charges (§ 213.4(d))	Yes	No
E. Total of payments (§ 213.4(e))	Yes	No
F. Regarding payment calculations,		
i. Gross capitalized cost (§ 213.4(f)(1))	Yes	No
ii. Capitalized cost reduction (§ 213.4(f)(2))	Yes	No
iii. Adjusted capitalized cost (§ 213.4(f)(3))	Yes	No
iv. Residual value (§ 213.4(f)(4))	Yes	No
v. Depreciation and any amortized amounts (§ 213.4(f)(5))	Yes	No
vi. Rent charge (§ 213.4(f)(6))	Yes	No
vii. Total of base periodic payments (§ 213.4(f)(7))	Yes	No
viii. Lease payments (§ 213.4(f)(8))	Yes	No
ix. Base periodic payment (§ 213.4(f)(9))	Yes	No
x. Itemization of other charges (§ 213.4(f)(10))	Yes	No
xi. Total periodic payment (§ 213.4(f)(11))	Yes	No
G. Regarding early termination,		
i. Conditions under which the lessee or lessor may terminate the lease prior to the end of the lease term (§ 213.4(g)(1))	Yes	No

ii. The amount of or description of the method for determining the amount of any penalty or other charges for early termination (§ 213.4(g)(1))	Yes	No
iii. In a form substantially similar to the sample (§ 213.4(g)(2))	Yes	No
H. Regarding notice of wear and use,		
i. Whether the lessor or the lessee is responsible for maintaining or servicing the leased property, with a description of the responsibility (§ 213.4(h)(1))	Yes	No
ii. Lessor's standards for wear and use, which must be reasonable (§ 213.4(h)(2))	Yes	No
iii. In a form substantially similar to the sample (§ 213.4(h)(3))	Yes	No
I. Purchase option (§ 213.4(i))	Yes	No
J. Statement referencing other nonsegregated disclosures (§ 213.4(j))	Yes	No
K. Liability between residual and realized values (§ 213.4(k))	Yes	No
L. Right of appraisal (§ 213.4(l))	Yes	No
M. For open-end leases,		
i. The rent and other charges paid by the lessee (§ 213.4(m)(1))	Yes	No
ii. Liability at end of lease term based on residual value and any excess liability (§ 213.4(m)(2))	Yes	No
iii. Mutually agreeable final adjustment (§ 213.4(m)(3))	Yes	No
N. Fees and taxes (§ 213.4(n))	Yes	No
O. Regarding insurance,		
i. Types and amounts of insurance that the lessee is required to have (§ 213.4(o))	Yes	No
ii. If the lessor provides insurance, types, amounts, and cost (§ 213.4(o)(1))	Yes	No
P. Warranties or guarantees (§ 213.4(p))	Yes	No
Q. Penalties and other charges for late payments, delinquency, or default (§ 213.4(q))	Yes	No
R. Security interest other than a security deposit (§ 213.4(r))	Yes	No
S. Regarding any information on rates,		
i. Does the lessor use the term "annual percentage rate," "annual lease rate," or any equivalent term in the lease disclosure? (§ 213.4(s))	Yes	No
ii. If so, does a statement that "This percentage may not measure the overall cost of financing this lease" accompany the rate? (§ 213.4(s))	Yes	No
13. Are disclosures given to lessees when they renegotiate or extend their lease? (§ 213.5)	Yes	No
14. Does the bank advertise its leasing program? If it does,		
A. Do the advertisements contain terms that are usually and customarily available? (§ 213.7(a))	Yes	No
B. Are the advertisements clear and conspicuous? (§ 213.7(b))	Yes	No
i. Are any affirmative or negative references to a charge that is part of the disclosure required under section 213.7(d)(2)(ii) less prominent than the disclosure (except for the statement of a periodic payment)? (§ 213.7(b)(1))	Yes	No
ii. Are the advertisements of lease rates less prominent than any disclosure required by section 213.4 (except the notice of the limitations on the rate)? (§ 213.7(b)(2))	Yes	No
C. Do catalog and multiple-page advertisements comply with the page-reference requirements? (§ 213.7(c))	Yes	No
D. If any triggering terms are used, are all the following disclosures made? (§ 213.7(d)(2))		
i. That the transaction advertised is a lease	Yes	No

ii. The total amount due prior to or at consummation or by delivery, if delivery occurs after consummation	Yes	No
iii. The number, amounts, and due dates or periods of scheduled payments under the lease	Yes	No
iv. Whether or not a security deposit is required	Yes	No
v. A statement that an extra charge may be imposed at the end of the lease term when the lessee's liability (if any) is based on the difference between the residual value of the leased property and its realized value at the end of the lease term	Yes	No
15. Do merchandise tags that use triggering terms refer to a sign or display that contains the additional required disclosures? (§ 213.7(e))	Yes	No
16. Do television and radio advertisements that do not contain the additional information required by section 213.4(d)(2) direct consumers to a toll-free number or a written advertisement for additional information when triggering terms are used? (§ 213.7)	Yes	No
A. Is the toll-free number listed along with a statement that the number may be used by consumers to obtain the information? (§ 213.7(f)(1)(i))	Yes	No
B. i. Is the written advertisement in a publication that is in general circulation in the community served by the station?	Yes	No
ii. Does the broadcast include the name and date of the publication?	Yes	No
iii. Is the publication published beginning at least three days before, and ending at least ten days after, the broadcast? (§ 213.7(f)(1)(ii))	Yes	No
C. Was the toll-free telephone number available for at least ten days, beginning on the date of broadcast? (§ 213.7(f)(2)(i))	Yes	No
D. Does the lessor provide the information required by section 213.7(d)(2) via the toll-free number orally, or in writing upon request? (§ 213.7(f)(2)(ii))	Yes	No
17. Are records and other evidence of compliance retained for at least two years? (§ 213.8)	Yes	No



# Regulation P

## Privacy of Consumer Financial Information

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### Background

Regulation P, Privacy of Consumer Financial Information, implements the privacy provisions of the Gramm–Leach–Bliley Act for state member banks. Generally, the act, which was signed into law in November 1999 and took effect in November 2000,

- Prohibits financial institutions from disclosing nonpublic personal information about consumers to nonaffiliated third parties, (1) unless the institution satisfies various notice and opt-out requirements and (2) provided that the consumer has not elected to opt out of the disclosure
- Requires institutions to provide notice of its privacy policies and practices to its customers

Regulation P establishes rules governing the duties of a financial institution to provide particular notices and limitations on its disclosure of nonpublic personal information. Compliance with the rules has been required since July 1, 2001. Generally, a financial institution

- Must provide a notice of its privacy policies to consumers and allow consumers to opt out of the disclosure of their nonpublic personal information to nonaffiliated third parties (subject to certain exceptions) if the disclosure is outside of the exceptions
- Must provide a notice of its privacy policies to its customers, whether or not the institution shares nonpublic personal information
- May not disclose customer account numbers to any nonaffiliated third party for marketing purposes
- Must follow reuse and redisclosure limitations on any nonpublic personal information it receives from nonaffiliated financial institutions

### Scope

Regulation P applies only to nonpublic personal information about individuals who obtain financial products or services primarily for personal, family, or household purposes. It does not apply to businesses or to individuals who obtain financial products or services for business, commercial, or agricultural purposes.

### Definitions and Key Concepts

Regulation P employs a number of key concepts when discussing the duties and limitations imposed by the regulation. These concepts are briefly

discussed below. A more complete explanation of each appears in the regulation.

#### Financial Institution

A *financial institution* is any institution whose business is engaging in activities that are financial in nature or incidental to such financial activities, as determined by section 4(k) of the Bank Holding Company Act of 1956. Financial institutions can include banks, securities brokers and dealers, insurance underwriters and agents, finance companies, mortgage bankers, and travel agents.<sup>1</sup>

#### Nonpublic Personal Information

Generally, *nonpublic personal information* is any financial information that is personally identifiable and not publicly available, including information that

- A consumer provides to a financial institution to obtain a financial product or service from the institution
- Results from a transaction between the consumer and the institution involving a financial product or service
- A financial institution otherwise obtains about a consumer in connection with providing a financial product or service

Information is considered *publicly available* if the institution has a reasonable basis for believing that the general public may lawfully access the information from government records, widely distributed media, or legally required disclosures to the general public. Examples include information listed in a telephone book or a publicly recorded document, such as a mortgage or securities filing.

Nonpublic personal information may include individual items of information as well as lists of information. For example, names, addresses, phone numbers, Social Security numbers, income, credit scores, and information obtained through Internet collection devices (that is, cookies) may be nonpublic information.

Regulation P includes special rules for lists. Publicly available information is considered nonpublic if it is derived from a source of nonpublic

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1. Certain functionally regulated subsidiaries, such as brokers, dealers, and investment advisers, are subject to privacy regulations issued by the Securities and Exchange Commission. Insurance entities may be subject to privacy regulations issued by their respective state insurance authorities.



personal information. For example, a list of the names and addresses of a financial institution's depositors derived from the financial institution's records (which are not publicly available) would be considered nonpublic personal information even though the names and addresses of these individuals might be published in local telephone directories.

However, if the financial institution has a reasonable basis for believing that certain customer relationships are a matter of public record, then any list of these relationships would be considered publicly available information. For instance, a list of mortgage customers whose mortgages are recorded in public records would be considered publicly available information. The institution could provide a list of such customers, and include on the list any other publicly available information it has about those customers, without having to provide to its customers a notice or the possibility of opting out.

### Nonaffiliated Third Party

A *nonaffiliated third party* is any person, except a financial institution's affiliate or a person employed jointly by a financial institution and a company, that is not the institution's affiliate. An *affiliate* of a financial institution is any company that controls, is controlled by, or is under common control with the financial institution.

### Opt-Out Right and Exceptions

#### *Opt-Out Right*

With certain exceptions, consumers must be given the right to *opt out* of the disclosure of their nonpublic personal information—that is, to prevent a financial institution from disclosing nonpublic personal information about them to a nonaffiliated third party—including a reasonable opportunity and a reasonable means of opting out. What constitutes a *reasonable opportunity to opt out* depends on the circumstances surrounding the consumer's transaction, but a consumer must be provided a reasonable amount of time to exercise the opt-out right. For example, thirty days from the date a notice is mailed or a customer acknowledges receipt of an electronic notice would be a reasonable amount of time for the customer to return an opt-out direction.

A *reasonable means to opt out* may include a check-off box, a reply form, or a toll-free telephone number, again depending on the circumstances surrounding the consumer's transaction. It is not reasonable to require a consumer to write his or her own letter as the only means of opting out.

#### *Exceptions*

Exceptions to the opt-out right are detailed in sections 13, 14, and 15 of Regulation P. Financial institutions need not comply with opt-out requirements if they limit their disclosure of nonpublic personal information

- To a nonaffiliated third party to perform services for the financial institution or to function on its behalf, including marketing the institution's own products or services or those offered jointly by the institution and another financial institution. The exception is permitted only if the financial institution provides notice of these arrangements and by contract prohibits the third party from disclosing or using the information for other than the specified purposes. The contract must provide that the parties to the agreement are jointly offering, sponsoring, or endorsing a financial product or service. However, if the service or function is covered by the exceptions in section 14 or 15 (discussed below), the financial institution does not have to comply with the additional disclosure and confidentiality requirements of section 13. Disclosure under this exception could include the outsourcing of marketing to an advertising company. (section 13)
- As necessary to effect, administer, or enforce a transaction that a consumer requests or authorizes, or under certain other circumstances relating to existing relationships with customers. Disclosures under this exception could be in connection with the audit of credit information or the administration of a rewards program or to provide an account statement. (section 14)
- For specified other disclosures that a financial institution normally makes, such as to protect against or prevent actual or potential fraud; to the financial institution's attorneys, accountants, and auditors; or to comply with applicable legal requirements, such as the disclosure of information to regulators. (section 15)

### Consumer and Customer

The distinction between consumers and customers is significant because financial institutions have additional disclosure duties with respect to customers. All customers covered by the regulation are consumers, but not all consumers are customers.

A *consumer* is an individual, or that individual's legal representative, who obtains or has obtained from a financial institution a financial product or service that is to be used primarily for personal, family, or household purposes. A *financial service* includes a financial institution's evaluation of or brokerage of information that the institution collects in connection with a request or an application from

a consumer for a financial product or service. For example, a financial service includes a lender's evaluation of an application for a consumer loan or for opening a deposit account, even if the application is ultimately rejected or withdrawn.

A *customer* is a consumer who has a customer relationship with a financial institution. A *customer relationship* is a *continuing* relationship between a consumer and a financial institution under which the institution provides one or more financial products or services to the consumer that are to be used primarily for personal, family, or household purposes. For example, a customer relationship may be established when a consumer engages in one of the following activities with a financial institution:

- Maintains a deposit or investment account
- Obtains a loan
- Enters into a lease of personal property
- Obtains financial, investment, or economic advisory services for a fee

Customers are entitled to receive an initial and an annual privacy notice regardless of the information-disclosure practices of their financial institution.

Consumers who are not customers are entitled to an initial privacy and opt-out notice only if the financial institution wants to share their nonpublic personal information with nonaffiliated third parties outside of the exceptions.

There is a special rule for loans. When a financial institution sells the servicing rights for a loan to another financial institution, the customer relationship transfers with the servicing rights. However, if the institution sells the servicing rights, any information the institution retains about the borrower must be accorded the protections due any consumer.

Note that isolated transactions alone will not cause a consumer to be treated as a customer. For example, if an individual purchases a bank check from a financial institution at which he or she does not have an account, the individual is a consumer but not a customer of that institution because he or she has not established a customer relationship. Likewise, if an individual uses the ATM of a financial institution at which he or she has no account, even uses that ATM repeatedly, the individual is a consumer but is not a customer of that institution.

## Financial Institution Duties

Regulation P establishes specific duties and limitations for a financial institution according to its activities. Institutions that intend to disclose nonpublic personal information outside the exceptions

must provide opt-out rights to their customers and to consumers who are not customers. All financial institutions must provide an initial and annual notice of their privacy policies to their customers. And all institutions must abide by the regulatory limits on the disclosure of account numbers to nonaffiliated third parties and on the redisclosure and reuse of nonpublic personal information received from nonaffiliated financial institutions. A summary of financial institution duties and limitations follows.

## Notice and Opt-out Duties to Consumers

If a financial institution intends to disclose nonpublic personal information about any of its consumers (whether or not they are customers) to a nonaffiliated third party and an exception does not apply, the institution must provide to the consumer

- An initial notice of its privacy policies
- An opt-out notice (including, among other things, a reasonable means of opting out)
- A reasonable opportunity, before the institution discloses the information to the nonaffiliated third party, to opt out

Generally, a financial institution may not disclose any nonpublic personal information to nonaffiliated third parties unless these notices have been provided *and* the consumer has not opted out. Additionally, the institution must provide a *revised notice* before it begins to share a new category of nonpublic personal information or shares information with a new category of nonaffiliated third parties in a manner that was not described in the previous notice.

Note that a financial institution need not comply with the initial and opt-out notice requirements for consumers who are not customers if the institution limits disclosure of nonpublic personal information to the exceptions.

## Notice Duties to Customers

In addition to the duties to consumers described in the preceding section, financial institutions have several duties specifically to customers. In particular, regardless of whether the institution discloses or intends to disclose nonpublic personal information, it must provide notice to its customers of its privacy policies and practices at various times. Briefly, a financial institution

- Must provide an *initial notice* of its privacy policies and practices to each customer, no later than the time a customer relationship is established. Instances in which the notice may be provided *after* the customer relationship has

been established are described in section 4(e) of the regulation.

- Must provide an *annual notice* at least once in any period of twelve consecutive months during the continuation of the customer relationship
- Must provide a *new notice* to an existing customer when the customer obtains a new financial product or service from the institution if the initial or annual notice most recently provided to the customer was *not* accurate with respect to the new financial product or service
- Has the option of providing a simplified notice when the institution does not disclose nonpublic personal information (other than as permitted under section 14 and section 15 exceptions) and does not reserve the right to do so

## Requirements for Notices

### *Clear and Conspicuous*

Privacy notices must be clear and conspicuous, meaning that they must be reasonably understandable and designed to call attention to the nature and significance of the information contained in the notice. While the regulation does not prescribe specific methods for making a notice clear and conspicuous, it does suggest ways in which to achieve the standard, such as using short explanatory sentences or bullet lists, plain-language headings, and easily readable typefaces and type sizes. Privacy notices also must accurately reflect the institution's privacy practices.

### *Delivery Rules*

Privacy notices must be provided so that each recipient can reasonably be expected to receive actual notice in writing or, if the consumer agrees, electronically. To meet this standard, a financial institution could, for example, (1) hand-deliver a printed copy of the notice to a consumer, (2) mail a printed copy of the notice to the consumer's last known address, or (3) for consumers who conduct transactions electronically, post the notice on the institution's web site and require the consumer to acknowledge receipt of the notice before completing the transaction.

For customers only, a financial institution must provide the initial notice (as well as the annual notice and any revised notice) so that a customer can retain or subsequently access the notice. A written notice satisfies this requirement. For customers who obtain financial products or services electronically and agree to receive their notices on the institution's web site, the institution may provide the current version of its privacy notice on its web site.

### *Notice Content*

A privacy notice must contain specific disclosures. However, a financial institution may provide consumers who are not customers a "short form" initial notice together with an opt-out notice (1) stating that the institution's privacy notice is available upon request and (2) explaining a reasonable means for the consumer to obtain it. The following information regarding nonpublic personal information must be provided in privacy notices, as applicable:

- Categories of information collected
- Categories of information disclosed
- Categories of affiliates and nonaffiliated third parties to whom the institution may disclose information
- Policies with respect to the treatment of former customers' information
- Information disclosed to service providers and joint marketers (section 13)
- Explanation of the opt-out right and methods of opting out
- Any opt-out notices the institution must provide under the Fair Credit Reporting Act with respect to affiliate information sharing
- Policies for protecting the security and confidentiality of information
- A statement that the institution makes disclosures to other nonaffiliated third parties as permitted by law (sections 14 and 15)

## Limitations on Disclosure of Account Numbers

A financial institution must not disclose an account number or similar form of access number or access code for a credit card, deposit account, or transaction account to any nonaffiliated third party (other than a consumer reporting agency) for use in telemarketing, direct mail marketing, or other marketing through electronic mail to the consumer. Encrypted account numbers without an accompanying means of decryption, however, are not subject to this prohibition.

The regulation also expressly allows financial institutions to disclose account numbers to an agent to market the institution's own products or services (although the institution must not authorize the agent to initiate charges to the customer's account). Also not barred are disclosures to participants in private-label or affinity card programs, for which the participants are identified to the customer when the customer enters the program.

## Redisclosure and Reuse Limitations on Nonpublic Personal Information Received

If a financial institution receives nonpublic personal information from a nonaffiliated financial institution, the disclosure and use of this information is limited.

- For nonpublic personal information received under a section 14 or 15 exception, the financial institution is limited to
  - Disclosing the information to the affiliates of the financial institution from which it received the information
  - Disclosing the information to its own affiliates, who may, in turn, disclose and use the information only to the extent that the financial institution may do so
  - Disclosing and using the information to carry out the activities covered by a section 14 or 15 exception (for example, an institution receiving information for account processing could disclose the information to its auditors)
- For nonpublic personal information not received under a section 14 or 15 exception, the recipient's use of the information is unlimited, but its disclosure of the information is limited to
  - Disclosing the information to the affiliates of the financial institution from which it received the information
  - Disclosing the information to its own affiliates, who may, in turn disclose the information only to the extent that the financial institution may do so
  - Disclosing the information to any other person, if the disclosure would be lawful if made directly to that person by the financial institution from which it received the information. For example, an institution that received a customer list from another financial institution could disclose the list (1) in accordance with the privacy policy of the financial institution that provided the list, (2) subject to any opt-out election or revocation by the consumers on the list, and (3) in accordance with appropriate exceptions under sections 14 and 15.

## Other Matters

### Fair Credit Reporting Act

Regulation P does not modify, limit, or supersede the operation of the Fair Credit Reporting Act.

## State Law

Regulation P does not supersede, alter, or affect any state statute, regulation, order, or interpretation, except to the extent that it is inconsistent with the regulation. A state statute, regulation, order, or other interpretation is consistent with the regulation if it affords any consumer greater protection than that provided under the regulation, as determined by the Federal Trade Commission.

## Grandfathered Service Contracts

Contracts that a financial institution entered into on or before July 1, 2000, with a nonaffiliated third party to perform services for the financial institution or functions on its behalf, as described in section 13, satisfied the confidentiality requirements of section 13(a)(1)(ii) until July 1, 2002, even if the contract did not include a requirement that the third party maintain the confidentiality of nonpublic personal information.

## Guidelines for Protecting Customer Information

Regulation P requires a financial institution to disclose its policies and practices for protecting the confidentiality, security, and integrity of nonpublic personal information about consumers (whether or not they are customers). The disclosure need not describe these policies and practices in detail. Instead, the disclosures may describe in general terms who is authorized to have access to the information and whether the institution has security practices and procedures in place to ensure the confidentiality of the information in accordance with the institution's policies.

The FFIEC (Federal Financial Institutions Examination Council) has published guidelines, pursuant to section 501(b) of the Gramm–Leach–Bliley Act, that address the steps a financial institution should take in order to protect customer information. The guidelines relate only to information about customers, rather than all consumers. Compliance examiners should consider the findings of a 501(b) inspection during the compliance examination of a financial institution for purposes of evaluating the accuracy of the institution's disclosure regarding data security.



# Regulation P

## Examination Objectives and Initial Examination Procedures

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### EXAMINATION OBJECTIVES

1. To assess the quality of a financial institution's compliance management policies and procedures for implementing Regulation P, specifically, ensuring consistency between what the financial institution tells consumers in its notices about its policies and practices and what it actually does
2. To determine the reliance that can be placed on a financial institution's internal controls and procedures for monitoring the institution's compliance with Regulation P
3. To determine a financial institution's compliance with Regulation P, specifically in meeting the following requirements:
  - Providing to customers notices of its privacy policies and practices that are timely, accurate, clear and conspicuous, and delivered so that each customer can reasonably be expected to receive actual notice
  - Disclosing nonpublic personal information to nonaffiliated third parties, other than under an exception, after first meeting the applicable requirements for giving consumers notice and the right to opt out
  - Appropriately honoring consumer opt-out directions
  - Lawfully using or disclosing nonpublic personal information received from a nonaffiliated financial institution
  - Disclosing account numbers only according to the limits in the regulation
4. To initiate effective corrective actions when violations of law are identified, or when policies or internal controls are deficient

### INITIAL EXAMINATION PROCEDURES

- A. Through discussions with management and review of available information, identify the institution's practices of sharing information with affiliates and nonaffiliated third parties (and changes in those practices); how the institution treats nonpublic personal information; and how it administers opt-outs. Consider the following, as appropriate:
  1. Notices (initial, annual, revised, opt-out, short-form, and simplified)
  2. Institutional privacy policies and procedures, including those to
    - Process requests for nonpublic personal

- information, including requests for aggregated data
  - Deliver notices to consumers
  - Manage consumer opt-out directions (for example, designating opt-out files, allowing a reasonable time to opt out, providing new opt-out and privacy notices when necessary, receiving opt-out directions, handling joint account holders)
  - Prevent the unlawful disclosure and use of the information received from nonaffiliated financial institutions
  - Prevent the unlawful disclosure of account numbers
3. Information-sharing agreements between the institution and affiliates as well as service agreements or contracts between the institution and nonaffiliated third parties to obtain or provide information or services
4. Complaint logs, telemarketing scripts, and any other information obtained from nonaffiliated third parties (Note: Review telemarketing scripts to determine whether the contractual terms set forth under section 13 are met and whether the institution is disclosing account-number information in violation of section 12.)
5. Categories of nonpublic personal information collected from or about consumers when obtaining a financial product or service (for example, in the application process for deposit, loan, or investment products; for an over-the-counter purchase of a bank check; from e-banking products or services, including the data collected electronically through Internet cookies; or through ATM transactions)
6. Categories of nonpublic personal information shared with, or received from, each nonaffiliated third party
7. Consumer complaints regarding the treatment of nonpublic personal information, including complaints received electronically
8. Records that reflect the bank's categorization of its information-sharing practices under sections 13, 14, and 15 and outside these exceptions
9. Results of a 501(b) inspection (used to determine the accuracy of the institution's privacy disclosures regarding data security)
- B. Use the information gathered via procedure A to work through the "Privacy Notices and Opt-Out

Provisions” decision tree (appendix A at the end of this chapter). Identify which of the six examination procedures modules is (are) applicable. (The modules follow this set of initial procedures.)

- C. Use the information gathered via procedure A to work through the “Reuse and Redisclosure” and “Account-Number Sharing” decision trees, as necessary (appendixes B and C at the end of this chapter). Identify the applicable examination procedures module(s).
- D. Determine the adequacy of the financial institution’s internal controls and procedures to ensure compliance with Regulation P. Consider all of the following:
  1. Sufficiency of internal policies, procedures, and controls, including those related to new products and services and controls over servicing arrangements and marketing arrangements
  2. Effectiveness of management information systems, including exception reports, the standardization of forms and procedures, and the use of technology for monitoring
  3. Frequency and effectiveness of monitoring procedures
  4. Adequacy and regularity of the institution’s training program
  5. Suitability of the compliance audit program for ensuring that
    - The procedures address all regulatory provisions, as applicable
    - The work is accurate and comprehensive with respect to the institution’s information-sharing practices
    - The frequency is appropriate
    - Conclusions are appropriately reached and presented to responsible parties
    - Steps are taken to correct deficiencies and to follow up on previously identified deficiencies
  6. Knowledge level of management and personnel
- E. Ascertain areas of risk associated with the financial institution’s sharing practices (especially those within section 13 and those that fall outside the exceptions) and any weaknesses found within the compliance management program. Follow up on any outstanding deficiencies identified in the audit when completing the modules.
- F. On the basis of the results of the foregoing initial procedures and discussions with management, determine which procedures in the applicable examination procedures module, if any, should be completed, focusing on areas of particular risk. The selection of procedures to be completed depends on the adequacy of the institution’s compliance management system and the level of risk identified. Each module contains a set of general instructions for verifying compliance, cross-referenced to cites within the regulation. Each module also contains cross-references to more questions, which the examiner may use if needed to evaluate compliance in more detail.
- G. Evaluate any additional information or documentation discovered during the course of the examination according to these procedures. Note that this may reveal new or different sharing practices, necessitating reapplication of the decision trees and completion of additional or different modules.
- H. Formulate conclusions.
  1. Summarize all findings.
  2. For violation(s) noted, determine the cause by identifying weaknesses in internal controls, compliance review, training, management oversight, or other areas.
  3. Identify action needed to correct violations and weaknesses in the institution’s compliance system, as appropriate.
  4. Discuss findings with management, and obtain a commitment for corrective action.

# Regulation P

## Examination Procedures—Module 1

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*For reviewing the sharing of nonpublic personal information with nonaffiliated third parties under sections 14 and/or 15 of Regulation P and outside the exceptions (with or without also sharing under section 13)*

(Note: Financial institutions whose practices fall within this category engage in the most expansive degree of information sharing permissible. Consequently, these institutions are held to the most comprehensive compliance standards imposed by the privacy regulation.)

### A. Disclosure of Nonpublic Personal Information

1. Select a sample of third-party relationships with nonaffiliated third parties, and then a sample of data shared between the institution and the third party both inside and outside the exceptions. The sample should include a cross-section of relationships but should emphasize those that are higher risk in nature as determined by the initial procedures. Make the following comparisons to evaluate the financial institution's compliance with disclosure limitations:
  - a. Compare the categories of data shared and the entities with which the data were shared with the categories stated in the privacy notice. Verify that what the institution tells consumers (customers and those who are not customers) in its notices about its policies and practices in this regard is consistent with what the institution actually does. (§§ 216.10 and 6)
  - b. Compare the data shared with a sample of opt-out directions and verify that only nonpublic personal information covered under the exceptions, or from consumers (customers and those who are not customers) who chose not to opt out, is shared. (§ 216.10)
2. If the financial institution also shares information under section 13, obtain and review contracts with nonaffiliated third parties that perform services for the financial institution that are not covered by the exceptions in section 14 or 15. Determine whether the contracts prohibit the third party from disclosing or using the information other than to carry out the purposes for which the information was disclosed. Note that the "grandfather" provisions of section 18 may apply to certain contracts. (§ 216.13(a))

### B. Presentation, Content, and Delivery of Privacy Notices

1. Review the financial institution's initial, annual, and revised notices as well as any short-form notices that the institution may use for consumers who are not customers. Determine whether or not these notices
  - a. Are clear and conspicuous (§§ 216.3(b), 4(a), 5(a)(1), and 8(a)(1))
  - b. Accurately reflect the institution's policies and practices (§§ 216.4(a), 5(a)(1), and 8(a)(1)) (Note: This includes practices disclosed in the notices that exceed regulatory requirements.)
  - c. Include, and adequately describe, all required items of information and contain examples, as applicable (§ 216.6) (Note that if the institution shares information under section 13, the notice provisions for that section also apply.)
2. Through discussions with management, a review of the institution's policies and procedures, and a sample of electronic or written consumer records when available, determine if the institution has adequate procedures in place to provide notices to consumers, as appropriate. Assess the following:
  - a. Timeliness of delivery (§§ 216.4(a), 7(c), and 8(a))
  - b. Reasonableness of the method of delivery (for example, by hand; by mail; electronically, if the consumer agrees; or as a necessary step of a transaction) (§ 216.9)
  - c. For customers only, review the timeliness of delivery (§§ 216.4(d), 4(e), and 5(a)), the means of delivery of the annual notice (§ 216.9(c)), and the accessibility of or ability to retain the notice (§ 216.9(e)).

### C. Opt-Out Right

1. Review the financial institution's opt-out notices. An opt-out notice may be combined with the institution's privacy notices. Regardless, determine whether the opt-out notices
  - a. Are clear and conspicuous (§§ 216.3(b) and 7(a)(1))
  - b. Accurately explain the right to opt out (§ 216.7(a)(1))
  - c. Include and adequately describe the three required items of information (the



institution’s policy regarding disclosure of nonpublic personal information, the consumer’s opt-out right, and the means to opt out) (§ 216.7(a)(1))

- d. Describe how the institution treats joint consumers (customers and those who are not customers), as applicable (§ 216.7(d))
2. Through discussions with management, a review of the institution’s policies and procedures, and a sample of electronic or written records where available, determine if the institution has adequate procedures in place to provide the opt-out notice and comply with the opt-out directions of consumers (customers and those who are not customers), as appropriate. Assess the following:
- a. Timeliness of delivery (§ 216.10(a)(1))
  - b. Reasonableness of the method of delivery (for example, by hand; by mail; electronically, if the consumer agrees; or as a necessary step of a transaction) (§ 216.9)
  - c. Reasonableness of the opportunity to opt out (the time period, and the means by which the consumer may opt out) (§§ 216.10(a)(1)(iii) and 10(a)(3))

- d. Adequacy of procedures to implement and track the status of consumers’ (customers and those who are not customers) opt-out directions, including those of former customers (§ 216.7(e), (f), and (g))

D. Checklist Cross-References

<i>Regulation section</i>	<i>Subject</i>	<i>Checklist questions</i>
216.4(a), 6(a, b, c, e), and 9(a, b, g)	Privacy notices (presentation, content, and delivery)	2, 8–11, 14, 18, 35, 36, and 40
216.4(a, c, d, e), 5, and 9(c, e)	Rules for delivering customer notices	1, 3–7, 37, and 38
216.13	Section 13 notice and contracting rules (as applicable)	12 and 47
216.6(d)	Short-form notice rules (optional for consumers only)	15–17
216.7, 8, and 10	Opt-out rules	19–34 and 41–43
216.14 and 15	Exceptions	48–50

# Regulation P

## Examination Procedures—Module 2

*For reviewing the sharing of nonpublic personal information with nonaffiliated third parties under sections 13, 14, and 15 of Regulation P, but not outside these exceptions*

### A. Disclosure of Nonpublic Personal Information

1. Select a sample of third-party relationships with nonaffiliated third parties, and then a sample of data shared between the institution and the third party. The sample should include a cross-section of relationships but should emphasize those that are higher risk in nature as determined by the initial procedures. Make the following comparisons to evaluate the financial institution's compliance with disclosure limitations:

- a. Review the data shared and the entities with which the data were shared to ensure that the institution accurately categorized its information-sharing practices and is not sharing nonpublic personal information outside the exceptions. (§§ 216.13–15)
- b. Compare the categories of data shared and the entities with which the data were shared with the categories stated in the privacy notice. Verify that what the institution tells consumers in its notices about its policies and practices in this regard is consistent with what the institution actually does. (§§ 216.10 and 6)

2. Review contracts with nonaffiliated third parties that perform services for the financial institution that are not covered by the exceptions in section 14 or 15. Determine whether the contracts adequately prohibit the third party from disclosing or using the information other than to carry out the purposes for which the information was disclosed. Note that the “grandfather” provisions of section 18 apply to certain of these contracts. (§ 216.13(a))

### B. Presentation, Content, and Delivery of Privacy Notices

1. Review the financial institution's initial and annual privacy notices. Determine whether or not they

- a. Are clear and conspicuous (§§ 216.3(b), 4(a), and 5(a)(1))
  - b. Accurately reflect the institution's policies and practices (§ 216.4(a) and 5(a)(1)) (Note: This includes practices disclosed in the notices that exceed regulatory requirements.)
  - c. Include, and adequately describe, all required items of information and contain examples as applicable (§§ 216.6 and 13)
2. Through discussions with management, a review of the institution's policies and procedures, and a sample of electronic or written consumer records when available, determine if the institution has adequate procedures in place to provide notices to consumers, as appropriate. Assess the following:
    - a. Timeliness of delivery (§ 216.4(a))
    - b. Reasonableness of the method of delivery (for example, by hand; by mail; electronically, if the consumer agrees; or as a necessary step of a transaction) (§ 216.9)
    - c. For customers only, review the timeliness of delivery (§§ 216.4(d), 4(e), and 5(a)), the means of delivery of the annual notice (§ 216.9(c)), and the accessibility of or ability to retain the notice. (§ 216.9(e))

### C. Checklist Cross-References

<i>Regulation section</i>	<i>Subject</i>	<i>Checklist questions</i>
216.4(a), 6(a, b, c, e), and 9(a, b, g)	Privacy notices (presentation, content, and delivery)	2, 8–11, 14, 18, 35, 36, and 40
216.13	Section 13 notice and contracting rules (as applicable)	12 and 47
216.4(a, c, d, e), 5, and 9(c, e)	Rules for delivering customer notices	1, 3–7, 37, and 38
216.14 and 15	Exceptions	48–50



# Regulation P

## Examination Procedures—Module 3

*For reviewing the sharing of nonpublic personal information with nonaffiliated third parties only under sections 14 and 15 of Regulation P*

(Note: This module applies only to customers.)

### A. Disclosure of Nonpublic Personal Information

1. Select a sample of third-party relationships with nonaffiliated third parties, and then a sample of data shared between the institution and the third party.
2. Review the data shared and the entities with which the data were shared to ensure that the institution accurately states its information-sharing practices and is not sharing nonpublic personal information outside the exceptions.

### B. Presentation, Content, and Delivery of Privacy Notices

1. Obtain and review the financial institution's initial and annual notices, as well as any simplified notice the institution may use. Note that the institution may use the simplified notice only when it does not also share nonpublic personal information with affiliates outside section 14 and 15 exceptions. Determine whether or not these notices
  - a. Are clear and conspicuous (§§ 216.3(b), 4(a), and 5(a)(1))
  - b. Accurately reflect the institution's policies and practices (§§ 216.4(a) and 5(a)(1)) (Note: This includes practices disclosed in the notices that exceed regulatory requirements.)

- c. Include, and adequately describe, all required items of information (§ 216.6)
2. Through discussions with management, a review of the institution's policies and procedures, and a sample of electronic or written customer records when available, determine if the institution has adequate procedures in place to provide notices to customers, as appropriate. Assess the following:
  - a. Timeliness of delivery (§§ 216.4(a), 4(d), 4(e), and 5(a))
  - b. Reasonableness of the method of delivery (for example, by hand; by mail; electronically, if the customer agrees; or as a necessary step of a transaction) (§ 216.9) and the accessibility of or ability to retain the notice (§ 216.9(e))

### C. Checklist Cross-References

<i>Regulation section</i>	<i>Subject</i>	<i>Checklist questions</i>
216.6	Customer-notice content and presentation	8–11, 14, and 18
216.6(c)(5)	Simplified-notice content (optional)	13
216.4(a, d, e), 5, and 9	Customer-notice delivery process	1, 3–7, and 35–40
216.14 and 15	Exceptions	48–50



# Regulation P

## Examination Procedures—Module 4

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*For reviewing the reuse and redisclosure of non-public personal information received from a non-affiliated financial institution under sections 14 and 15 of Regulation P*

- A. Through discussions with management and a review of the institution's procedures, determine whether the institution has adequate practices in place to prevent the unlawful redisclosure and reuse of information when the institution is the recipient of nonpublic personal information. (§ 216.11(a))
- B. Select a sample of data received from nonaffiliated financial institutions to evaluate the financial institution's compliance with reuse and redisclosure limitations.

- 1. Verify that the institution redisclosed information only to affiliates of the financial institution from which the information was obtained or to the institution's own affiliates, except as otherwise allowed. (§ 216.11(a)(1)(i) and (ii))
- 2. Verify that the institution uses and shares the data only pursuant to an exception in sections 14 and 15. (§ 216.11(a)(1)(iii))

### C. Checklist Cross-References

<i>Regulation section</i>	<i>Subject</i>	<i>Checklist question</i>
216.11(a)	Reuse and redisclosure	44



# Regulation P

## Examination Procedures—Module 5

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*For reviewing the redisclosure of nonpublic personal information received from a nonaffiliated financial institution outside sections 14 and 15 of Regulation P*

- A. Through discussions with management and a review of the institution's procedures, determine whether the institution has adequate practices in place to prevent the unlawful redisclosure of information when the institution is the recipient of nonpublic personal information. (§ 216.11(b))
- B. Select a sample of data received from nonaffiliated financial institutions and shared with others to evaluate the financial institution's compliance with the redisclosure limitations.
  - 1. Verify that the institution's redisclosure of the information was only to affiliates of the financial institution from which the information was obtained or to the institution's own

affiliates, except as otherwise allowed. (§§ 216.11(b)(1)(i) and (ii))

- 2. If the institution shares information, verify that the institution's information-sharing practices conform to those in the nonaffiliated financial institution's privacy notice. (§ 216.11(b)(1)(iii))
- 3. Also, review the procedures used by the institution to ensure that the information-sharing reflects the opt-out status of the consumers of the nonaffiliated financial institution. (§§ 216.10 and 11(b)(1)(iii))

### C. Checklist Cross-References

<i>Regulation section</i>	<i>Subject</i>	<i>Checklist question</i>
216.11(b)	Reuse and redisclosure	45





# Regulation P

## Examination Procedures—Module 6

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### *For reviewing the sharing of account numbers*

- A. If available, review a sample of telemarketing scripts used when making sales calls, to determine whether the scripts indicate that the telemarketers have the account numbers of the institution's consumers. (§ 216.12)
- B. Obtain and review a sample of contracts with agents or service providers to whom the financial institution discloses account numbers for use in connection with marketing the institution's own products or services. Determine whether the institution shares account numbers with nonaffiliated third parties only to conduct marketing for the institution's own products and services. Ensure that the contracts do not authorize these nonaffiliated third parties to

directly initiate charges to customer's accounts. (§ 216.12(b)(1))

- C. Obtain a sample of materials and information provided to the consumer upon entering a private-label or affinity credit card program. Determine if the participants in each program are identified to the customer when the customer enters into the program. (§ 216.12(b)(2))

### D. Checklist Cross-References

<i>Regulation section</i>	<i>Subject</i>	<i>Checklist question</i>
216.12	Account-number sharing	46



# Regulation P Examination Checklist

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## SUBPART A

### Initial Privacy Notice

- |   |     |    |
|---|-----|----|
| <p>1. Does the institution provide a clear and conspicuous notice that accurately reflects its privacy policies and practices to <i>all customers</i> not later than when the customer relationship is established, other than as allowed in paragraph (e) of section 216.4 of Regulation P? (§ 216.4(a)(1))</p> <p>Note: No notice is required if nonpublic personal information is disclosed to nonaffiliated third parties only under an exception in sections 216.14 and 15 and there is no customer relationship. (§ 216.4(b)) With respect to credit relationships, an institution establishes a customer relationship when it originates a consumer loan. If the institution subsequently sells the servicing rights to the loan to another financial institution, the customer relationship transfers with the servicing rights. (§ 216.4(c))</p> | Yes | No |
| <p>2. Does the institution provide a clear and conspicuous notice that accurately reflects its privacy policies and practices to <i>all consumers</i> who are not customers before any nonpublic personal information about the consumer is disclosed to a nonaffiliated third party, other than under an exception in section 216.14 or 15? (§ 216.4(a)(2))</p>  | Yes | No |
| <p>3. Does the institution provide to <i>existing customers</i> who obtain a new financial product or service an initial privacy notice that covers the customer's new financial product or service, if the most recent notice provided to the customer was not accurate with respect to the new financial product or service? (§ 216.4(d)(1))</p>  | Yes | No |
| <p>4. <i>After establishing a customer relationship</i>, does the institution provide initial notice only under one of the following circumstances?</p> <p>a. The customer relationship is not established at the customer's election (§ 216.4(e)(1)(i))</p> <p>b. To do otherwise would substantially delay the customer's transaction (for example, in the case of a telephone application) and the customer agrees to the subsequent delivery (§ 216.4 (e)(1)(ii))</p>   | Yes | No |
| <p>5. When the subsequent delivery of a privacy notice is permitted, does the institution provide notice after establishing a customer relationship within a reasonable time? (§ 216.4(e))</p>  | Yes | No |

### Annual Privacy Notice

- |  |     |    |
|--|-----|----|
| <p>6. Does the institution provide a clear and conspicuous notice that accurately reflects its privacy policies and practices at least annually (that is, at least once in any period of 12 consecutive months) to all customers, throughout the customer relationship? (§§ 216.5(a)(1) and (2))</p> <p>Note: Annual notices are not required for former customers. (§§ 216.5(b)(1) and (2))</p> | Yes | No |
| <p>7. Does the institution provide an annual privacy notice to each customer for whom the institution owns the loan-servicing rights? (§§ 216.5(c) and 4(c)(2))</p>  | Yes | No |

## Content of Privacy Notices

8. Do the initial, annual, and revised privacy notices include each of the following, as applicable?
- |  |     |    |
|--|-----|----|
| a. The categories of nonpublic personal information that the institution collects (§ 216.6(a)(1))  | Yes | No |
| b. The categories of nonpublic personal information that the institution discloses (§ 216.6(a)(2))   | Yes | No |
| c. The categories of affiliates and nonaffiliated third parties to whom the institution discloses nonpublic personal information, other than parties to whom information is disclosed under an exception in section 216.14 or 15 (§ 216.6(a)(3))   | Yes | No |
| d. The categories of nonpublic personal information disclosed about former customers, and the categories of affiliates and nonaffiliated third parties to whom the institution discloses information, other than those parties to whom the institution discloses information under an exception in section 216.14 or 15 (§ 216.6(a)(4))              | Yes | No |
| e. If the institution discloses nonpublic personal information to a nonaffiliated third party under section 216.13 and no exception under section 216.14 or 15 applies, a separate statement of the categories of information the institution discloses and the categories of third parties with whom the institution has contracted (§ 216.6(a)(5)) | Yes | No |
| f. An explanation of the opt-out right, including the method(s) of opting out that the consumer may use at the time of the notice (§ 216.6(a)(6))  | Yes | No |
| g. Any disclosures the institution makes under section 603(d)(2)(A)(iii) of the Fair Credit Reporting Act (§ 216.6(a)(7))  | Yes | No |
| h. The institution's policies and practices with respect to protecting the confidentiality and security of nonpublic personal information (§ 216.6(a)(8))  | Yes | No |
| i. A general statement—with no specific reference to the exceptions or to the third parties—that the institution makes disclosures to other nonaffiliated third parties as permitted by law (§§ 216.6(a)(9) and (b))   | Yes | No |
- Note: Sample clauses for these items appear in appendix A to Regulation P.
9. Does the institution list the following categories of nonpublic personal information that it collects, as applicable?
- |   |     |    |
|---|-----|----|
| a. Information from the consumer (§ 216.6(c)(1)(i))   | Yes | No |
| b. Information about the consumer's transactions with the institution or its affiliates (§ 216.6(c)(1)(ii)) | Yes | No |
| c. Information about the consumer's transactions with nonaffiliated third parties (§ 216.6(c)(1)(iii))      | Yes | No |
| d. Information from a consumer reporting agency (§ 216.6(c)(1)(iv))   | Yes | No |
10. Does the institution list the following categories of nonpublic personal information that it discloses, as applicable, and a few examples of each or, alternatively, state that it reserves the right to disclose all the nonpublic personal information that it collects?
- |   |     |    |
|---|-----|----|
| a. Information from the consumer  | Yes | No |
| b. Information about the consumer's transactions with the institution or its affiliates | Yes | No |
| c. Information about the consumer's transactions with nonaffiliated third parties       | Yes | No |

<p>d. Information from a consumer reporting agency (§ 216.6(c)(2))</p> <p>Note: Examples are recommended under section 216.6(c)(2), although not under section 216.6(c)(1).</p>	<p>Yes</p>	<p>No</p>
<p>11. Does the institution list the following categories of affiliates and nonaffiliated third parties to whom it discloses information, as applicable, and a few examples to illustrate the types of third parties in each category?</p>		
<p>a. Financial service providers (§ 216.6(c)(3)(i))</p>	<p>Yes</p>	<p>No</p>
<p>b. Nonfinancial companies (§ 216.6(c)(3)(ii))</p>	<p>Yes</p>	<p>No</p>
<p>c. Others (§ 216.6(c)(3)(iii))</p>	<p>Yes</p>	<p>No</p>
<p>12. Does the institution make the following disclosures regarding service providers and joint marketers to whom it discloses nonpublic personal information under section 216.13?</p>		
<p>a. As applicable, the same categories and examples of nonpublic personal information disclosed as described in paragraphs (a)(2) and (c)(2) of section 216.6 (see questions 8b and 10) (§ 216.6(c)(4)(i))</p>	<p>Yes</p>	<p>No</p>
<p>b. That the third party is a service provider that performs marketing on the institution's behalf or on behalf of the institution and another financial institution or (§ 216.6(c)(4)(ii)(A))</p>	<p>Yes</p>	<p>No</p>
<p>c. That the third party is a financial institution with which the institution has a joint marketing agreement (§ 216.6(c)(4)(ii)(B))</p>	<p>Yes</p>	<p>No</p>
<p>13. If the institution does not disclose nonpublic personal information and does not reserve the right to do so, other than under exceptions in sections 216.14 and 15, does the institution provide a simplified privacy notice that contains, at a minimum, all of the following?</p>		
<p>a. A statement to this effect</p>	<p>Yes</p>	<p>No</p>
<p>b. The categories of nonpublic personal information it collects</p>	<p>Yes</p>	<p>No</p>
<p>c. The policies and practices the institution uses to protect the confidentiality and security of nonpublic personal information</p>	<p>Yes</p>	<p>No</p>
<p>d. A general statement that the institution makes disclosures to other nonaffiliated third parties as permitted by law (§ 216.6(c)(5))</p>	<p>Yes</p>	<p>No</p>
<p>Note: Use of this type of simplified notice is optional; an institution may always use a full notice.</p>		
<p>14. Does the institution describe the following about its policies and practices with respect to protecting the confidentiality and security of nonpublic personal information?</p>		
<p>a. Who is authorized to have access to the information (§ 216.6(c)(6)(i))</p>	<p>Yes</p>	<p>No</p>
<p>b. Whether security practices and policies are in place to ensure the confidentiality of the information in accordance with the institution's policy (§ 216.6(c)(6)(ii))</p>	<p>Yes</p>	<p>No</p>
<p>Note: The institution is not required to describe technical information about the safeguards used in this respect.</p>		
<p>15. If the institution provides a short-form initial privacy notice with the opt-out notice, does the institution do so only to consumers with whom the institution does not have a customer relationship? (§ 216.6(d)(1))</p>	<p>Yes</p>	<p>No</p>
<p>16. If the institution provides a short-form initial privacy notice according to section 216.6(d)(1), does the short-form initial notice</p>		
<p>a. Conform to the definition of "clear and conspicuous," (§ 216.6(d)(2)(i))</p>	<p>Yes</p>	<p>No</p>

b. State that the institution's full privacy notice is available upon request and, (§ 216.6(d)(2)(ii))	Yes	No
c. Explain a reasonable means by which the consumer may obtain the notice (§ 216.6(d)(2)(iii))	Yes	No
Note: The institution is not required to deliver the full privacy notice with the short-form initial notice. (§ 216.6(d)(3))		
17. Does the institution provide consumers who receive the short-form initial notice with a reasonable means of obtaining the longer initial notice, such as		
a. A toll-free telephone number that the consumer may call to request the notice or (§ 216.6(d)(4)(i))	Yes	No
b. Copies available for immediate hand-delivery to consumers who conduct business in person at the institution's office (§ 216.6(d)(4)(ii))	Yes	No
18. If the institution, in its privacy policies, reserves the right to disclose nonpublic personal information to nonaffiliated third parties in the future, does the privacy notice include the following, as applicable?		
a. Categories of nonpublic personal information that the institution reserves the right to disclose in the future but does not currently disclose and (§ 216.6(e)(1))	Yes	No
b. Categories of affiliates or nonaffiliated third parties to whom the institution reserves the right in the future to disclose, but to whom it does not currently disclose, nonpublic personal information (§ 216.6(e)(2))	Yes	No

## Opt-Out Notice

19. If the institution discloses nonpublic personal information about a consumer to a nonaffiliated third party and the exceptions under sections 216.13–15 do not apply, does the institution provide the consumer with a clear and conspicuous opt-out notice that accurately explains the right to opt out? (§ 216.7(a)(1))	Yes	No
20. Does the opt-out notice state the following?		
a. That the institution discloses or reserves the right to disclose nonpublic personal information about the consumer to a nonaffiliated third party (§ 216.7(a)(1)(i))	Yes	No
b. That the consumer has the right to opt out of that disclosure (§ 216.7(a)(1)(ii))	Yes	No
c. A reasonable means by which the consumer may opt out (§ 216.7(a)(1)(iii))	Yes	No
21. Does the institution provide the consumer with the following information about the right to opt out?		
a. All the categories of nonpublic personal information that the institution discloses or reserves the right to disclose (§ 216.7(a)(2)(i)(A))	Yes	No
b. All the categories of nonaffiliated third parties to whom the information is disclosed (§ 216.7(a)(2)(i)(A))	Yes	No
c. That the consumer has the right to opt out of the disclosure of that information (§ 216.7(a)(2)(i)(A))	Yes	No
d. The financial products or services that the consumer obtains to which the opt-out direction would apply (§ 216.7(a)(2)(i)(B))	Yes	No
22. Does the institution provide the consumer with at least one of the following reasonable means of opting out, or with another reasonable means?		
a. Check-off boxes prominently displayed on the relevant forms with the opt-out notice (§ 216.7(a)(2)(ii)(A))	Yes	No

b. A reply form included with the opt-out notice (§ 216.7(a)(2)(ii)(B))	Yes	No
c. An electronic means to opt out, such as a form that can be sent via electronic mail or a process at the institution's web site, if the consumer agrees to the electronic delivery of information (§ 216.7(a)(2)(ii)(C))	Yes	No
d. A toll-free telephone number (§ 216.7(a)(2)(ii)(D))	Yes	No
Note: The institution may require the consumer to use one specific means of opting out, as long as that means is reasonable for that consumer. (§ 216.7(a)(iv))		
23. If the institution delivers the opt-out notice after the initial notice, does the institution provide the initial notice once again with the opt-out notice? (§ 216.7(c))	Yes	No
24. Does the institution provide an opt-out notice, to at least one party in a joint consumer relationship, explaining how the institution will treat opt-out directions by the joint consumers? (§ 216.7(d)(1))	Yes	No
25. Does the institution permit each of the joint consumers in a joint relationship to opt out? (§ 216.7(d)(2))	Yes	No
26. Does the opt-out notice to joint consumers state that either		
a. The institution will consider an opt-out by a joint consumer as applying to all associated joint consumers or (§ 216.7(d)(2)(i))	Yes	No
b. Each joint consumer is permitted to opt out separately (§ 216.7(d)(2)(ii))	Yes	No
27. If each joint consumer may opt out separately, does the institution permit		
a. One joint consumer to opt out on behalf of all of the joint consumers, (§ 216.7(d)(3))	Yes	No
b. The joint consumers to notify the institution in a single response, and (§ 216.7(d)(5))	Yes	No
c. Each joint consumer to opt out for himself or herself or for another joint consumer (§ 216.7(d)(5))	Yes	No
28. Does the institution refrain from requiring all joint consumers to opt out before implementing any opt-out direction with respect to the joint account? (§ 216.7(d)(4))	Yes	No
29. Does the institution comply with a consumer's direction to opt out as soon as is reasonably practicable after receiving it? (§ 216.7(e))	Yes	No
30. Does the institution allow the consumer to opt out at any time? (§ 216.7(f))	Yes	No
31. Does the institution continue to honor the consumer's opt-out direction until revoked by the consumer in writing or, if the consumer agrees, electronically? (§ 216.7(g)(1))	Yes	No
32. When a customer relationship ends, does the institution continue to apply the customer's opt-out direction to the nonpublic personal information collected during, or related to, that specific customer relationship (but not to new relationships, if any, subsequently established by that customer)? (§ 216.7(g)(2))	Yes	No

## Revised Notices

33. Except as permitted by sections 216.13–15, does the institution refrain from disclosing any nonpublic personal information about a consumer to a nonaffiliated third party, other than as described in the initial privacy notice provided to the consumer, unless



a.	The institution has provided the consumer with a clear and conspicuous revised notice that accurately describes the institution's privacy policies and practices, (§ 216.8(a)(1))	Yes	No
b.	The institution has provided the consumer with a new opt-out notice, (§ 216.8(a)(2))	Yes	No
c.	The institution has given the consumer a reasonable opportunity to opt out of the disclosure, before disclosing any information, and (§ 216.8(a)(3))	Yes	No
d.	The consumer has not opted out (§ 216.8(a)(4))	Yes	No
34.	Does the institution deliver a revised privacy notice when it does any one of the following?		
a.	Discloses a new category of nonpublic personal information to a nonaffiliated third party (§ 216.8(b)(1)(i))	Yes	No
b.	Discloses nonpublic personal information to a new category of nonaffiliated third party (§ 216.8(b)(1)(ii))	Yes	No
c.	Discloses nonpublic personal information about a former customer to a nonaffiliated third party, if that former customer has not had the opportunity to exercise an opt-out right regarding that disclosure (§ 216.8(b)(1)(iii))	Yes	No
	Note: A revised notice is not required if the institution adequately described the nonaffiliated third party or information to be disclosed in the prior privacy notice. (§ 216.8(b)(2))		

## Delivery Methods

35.	Does the institution deliver the privacy and opt-out notices, including the short-form notice, so that the consumer can reasonably be expected to receive the actual notice in writing or, if the consumer agrees, electronically? (§ 216.9(a))	Yes	No
36.	Does the institution use a reasonable means for delivering the notices, such as the following?		
a.	Hand-delivery of a printed copy (§ 216.9(b)(1)(i))	Yes	No
b.	Mailing a printed copy to the last known address of the consumer (§ 216.9(b)(1)(ii))	Yes	No
c.	For the consumer who conducts transactions electronically, posting the notice clearly and conspicuously on the institution's electronic site and requiring the consumer to acknowledge receipt as a necessary step to obtaining a financial product or service (§ 216.9(b)(1)(iii))	Yes	No
d.	For isolated transactions, such as ATM transactions, posting the notice on the screen and requiring the consumer to acknowledge receipt as a necessary step to obtaining the financial product or service (§ 216.9(b)(1)(iv))	Yes	No
	Note: Insufficient or unreasonable means of delivery include exclusively oral notice, in person or by telephone; branch or office signs or generally published advertisements; and electronic mail to a customer who does not obtain products or services electronically. (§§ 216.9(b)(2)(i) and (ii) and 216.9(d))		
37.	For annual notices only, if the institution does not employ one of the methods described in question 36, does the institution employ one of the following reasonable means of delivering the notice?		

a. For the customer who uses the institution's web site to access products and services electronically and who agrees to receive notices at the web site, continuously posting the current privacy notice on the web site in a clear and conspicuous manner (§ 216.9(c)(1))	Yes	No
b. For the customer who has requested that the institution refrain from sending any information about the customer relationship, making copies of the current privacy notice available upon customer request (§ 216.9(c)(2))	Yes	No
38. For customers only, does the institution ensure that the initial, annual, and revised notices can be retained or obtained later by the customer in writing or, if the customer agrees, electronically? (§ 216.9(e)(1))	Yes	No
39. Does the institution use an appropriate means to ensure that notices can be retained or obtained later, such as one of the following?		
a. Hand-delivery of a printed copy of the notice (§ 216.9(e)(2)(i))	Yes	No
b. Mailing a printed copy to the last known address of the customer (§ 216.9(e)(2)(ii))	Yes	No
c. Making the current privacy notice available on the institution's web site (or via a link to the notice at another site) for the customer who agrees to receive the notice at the web site (§ 216.9(e)(2)(iii))	Yes	No
40. Does the institution provide at least one initial, annual, and revised notice, as applicable, to joint consumers? (§ 216.9(g))	Yes	No

## SUBPART B

### Limits on Disclosure to Nonaffiliated Third Parties

41. Does the institution refrain from disclosing any nonpublic personal information about a consumer to a nonaffiliated third party, other than as permitted under sections 216.13–15, unless all of the following have occurred?		
a. It has provided the consumer with an initial notice. (§ 216.10(a)(1)(i))	Yes	No
b. It has provided the consumer with an opt-out notice. (§ 216.10(a)(1)(ii))	Yes	No
c. It has given the consumer a reasonable opportunity to opt out before the disclosure. (§ 216.10(a)(1)(iii))	Yes	No
d. The consumer has not opted out. (§ 216.10(a)(1)(iv))	Yes	No
Note: This disclosure limitation applies to consumers as well as to customers (§ 216.10(b)(1)), and to all nonpublic personal information regardless of whether it was collected before or after receiving an opt-out direction. (§ 216.10(b)(2))		
42. Does the institution provide the consumer with a reasonable opportunity to opt out, such as by one of the following?		
a. Mailing the notices required by section 216.10 and allowing the consumer to respond by toll-free telephone number, return mail, or other reasonable means (see question 22) within 30 days from the date mailed (§ 216.10(a)(3)(i))	Yes	No
b. Where the consumer opens an online account with the institution and agrees to receive the notices required by section 216.10 electronically, allowing the consumer to opt out by any reasonable means (see question 22) within 30 days from consumer acknowledgement of receipt of the notice in conjunction with opening the account (§ 216.10(a)(3)(ii))	Yes	No

- c. For isolated transactions, providing the notices required by section 216.10 at the time of the transaction and requesting that the consumer decide, as a necessary part of the transaction, whether to opt out before completion of the transaction (§ 216.10(a)(3)(iii)) Yes No
43. Does the institution allow the consumer to select certain nonpublic personal information or certain nonaffiliated third parties with respect to which the consumer wishes to opt out? (§ 216.10(c)) Yes No
- Note: An institution may allow partial opt-outs in addition to, but may not allow them instead of, a comprehensive opt-out.

### Limits on Rediscovery and Reuse of Information

44. If the institution receives information from a nonaffiliated financial institution under an exception in section 216.14 or 15, does the institution refrain from using or disclosing the information except under the following circumstances?
- a. Disclosure to the affiliates of the financial institution from which it received the information (§ 216.11(a)(1)(i)) Yes No
- b. Disclosure to its own affiliates, which are in turn limited by the same disclosure and use restrictions as the recipient institution (§ 216.11(a)(1)(ii)) Yes No
- c. Disclosure and use of the information pursuant to an exception in section 216.14 or 15 in the ordinary course of business to carry out the activity covered by the exception under which the information was received (§ 216.11(a)(1)(iii)) Yes No
- Note: The disclosure or use described in part c of this question need not be directly related to the activity covered by the applicable exception. For instance, an institution receiving information for fraud-prevention purposes could provide the information to its auditors. But “in the ordinary course of business” does not include marketing. (§ 216.11(a)(2))
45. If the institution receives information from a nonaffiliated financial institution other than under an exception in section 216.14 or 15, does the institution refrain from disclosing the information except under the following circumstances?
- a. To the affiliates of the financial institution from which it received the information (§ 216.11(b)(1)(i)) Yes No
- b. To its own affiliates, which are in turn limited by the same disclosure restrictions as the recipient institution (§ 216.11(b)(1)(ii)) Yes No
- c. To any other person, if the disclosure would be lawful if made directly to that person by the institution from which the recipient institution received the information (§ 216.11(b)(1)(iii)) Yes No

### Limits on Sharing Account-Number Information for Marketing Purposes

46. Does the institution refrain from disclosing, directly or through affiliates, account numbers or similar forms of access numbers or access codes for a consumer’s credit card account, deposit account, or transaction account to any nonaffiliated third party (other than to a consumer reporting agency) for telemarketing, direct mail, or electronic mail marketing to the consumer, except under the following circumstances?

- |  |     |    |
|--|-----|----|
| a. To the institution's agents or service providers solely to market the institution's own products or services, as long as the agent or service provider is not authorized to directly initiate charges to the account (§ 216.12(b)(1)) | Yes | No |
| b. To a participant in a private-label credit card program or an affinity or similar program in which the participants in the program are identified to the customer when the customer enters into the program (§ 216.12(b)(2))          | Yes | No |
- Note: An "account number or similar form of access number or access code" does not include numbers in encrypted form, so long as the institution does not provide the recipient with a means of decryption. (§ 216.12(c)(1)) A transaction account does not include an account to which third parties cannot initiate charges. (§ 216.12(c)(2))

## SUBPART C

### Exception to Opt-Out Requirements for Service Providers and Joint Marketing

- |   |     |    |
|---|-----|----|
| 47. If the institution discloses nonpublic personal information to a nonaffiliated third party without permitting the consumer to opt out, do the opt-out requirements of sections 216.7 and 10 and the revised notice requirements in section 216.8 not apply because  |     |    |
| a. The institution disclosed the information to a nonaffiliated third party who performs services for, or functions on behalf of, the institution (including joint marketing of financial products and services offered pursuant to a joint agreement as defined in paragraph (b) of section 216.13), (§ 216.13(a)(1))                              | Yes | No |
| b. The institution has provided consumers with the initial notice, and (§ 216.13(a)(1)(i))  | Yes | No |
| c. The institution has entered into a contract with that party prohibiting the party from disclosing or using the information except to carry out the purposes for which the information was disclosed, including use under an exception in section 216.14 or 15 in the ordinary course of business to carry out those purposes (§ 216.3(a)(1)(ii)) | Yes | No |

### Exceptions to Notice and Opt-Out Requirements for Processing and Servicing Transactions

- |   |     |    |
|---|-----|----|
| 48. If the institution discloses nonpublic personal information to nonaffiliated third parties, do certain requirements—for initial notice in section 216.4(a)(2); opt-out in sections 216.7 and 10; revised notice in section 216.8; and service providers and joint marketing in section 216.13—not apply because the information is disclosed as necessary to effect, administer, or enforce a transaction that the consumer requests or authorizes, or in connection with any of the following? |     |    |
| a. Servicing or processing a financial product or service requested or authorized by the consumer (§ 216.14(a)(1))  | Yes | No |
| b. Maintaining or servicing the consumer's account with the institution or with another entity as part of a private-label credit card program or other credit extension on behalf of the entity (§ 216.14(a)(2))  | Yes | No |
| c. Effecting a proposed or actual securitization, secondary-market sale (including sale of servicing rights), or other, similar transaction related to a transaction of the consumer (§ 216.14(a)(3))   | Yes | No |

49. If the institution uses a section 216.14 exception as necessary to effect, administer, or enforce a transaction, is the disclosure of nonpublic personal information		
a. Required, or one of the lawful or appropriate methods to enforce the rights of the institution or other persons engaged in carrying out the transaction or providing the product or service, or (§ 216.14(b)(1))	Yes	No
b. Required, or a usual, appropriate, or acceptable method under section 216.14(b)(2), to		
i. Carry out the transaction or the product or service business of which the transaction is a part, including recording, servicing, or maintaining the consumer's account in the ordinary course of business, (§ 216.14(b)(2)(i))	Yes	No
ii. Administer or service benefits or claims, (§ 216.14(b)(2)(ii))	Yes	No
iii. Confirm or provide a statement or other record of the transaction or information on the status or value of the financial service or financial product to the consumer or the consumer's agent or broker, (§ 216.14(b)(2)(iii))	Yes	No
iv. Accrue or recognize incentives or bonuses, (§ 216.14(b)(2)(iv))	Yes	No
v. Underwrite insurance or provide for reinsurance or for certain other purposes related to a consumer's insurance, or (§ 216.14(b)(2)(v))	Yes	No
vi. In connection with one of the following:		
(1) The authorization, settlement, billing, processing, clearing, transferring, reconciling, or collection of amounts charged, debited, or otherwise paid by using a debit, credit, or other payment card, check, or account number, or by other payment means (§ 216.14(b)(2)(vi)(A))	Yes	No
(2) The transfer of receivables, accounts, or interests therein (§ 216.4(b)(2)(vi)(B))	Yes	No
(3) The audit of debit, credit, or other payment information (§ 216.14(b)(2)(vi)(C))	Yes	No

### Other Exceptions to Notice and Opt-Out Requirements

50. If the institution discloses nonpublic personal information to nonaffiliated third parties, do certain requirements—for initial notice in section 216.4(a)(2); opt-out in sections 216.7 and 10; revised notice in section 216.8; and service providers and joint marketers in section 216.13—not apply because the institution makes the disclosure		
a. With the consent or at the direction of the consumer (§ 216.15(a)(1))	Yes	No
b. i. To protect the confidentiality or security of records (§ 216.15(a)(2)(i))	Yes	No
ii. To protect against or prevent actual or potential fraud, unauthorized transactions, claims, or other liability (§ 216.15(a)(2)(ii))	Yes	No
iii. For required institutional risk control or for resolving consumer disputes or inquiries (§ 216.15(a)(2)(iii))	Yes	No
iv. To persons holding a legal or beneficial interest relating to the consumer (§ 216.15(a)(2)(iv))	Yes	No
v. To persons acting in a fiduciary or representative capacity on behalf of the consumer (§ 216.15(a)(2)(v))	Yes	No
c. To insurance rate advisory organizations, guaranty funds or agencies, agencies rating the institution, persons assessing compliance, and the institution's attorneys, accountants, and auditors (§ 216.15(a)(3))	Yes	No

- |   |     |    |
|---|-----|----|
| d. In compliance with the Right to Financial Privacy Act, or to law enforcement agencies (§ 216.15(a)(4))   | Yes | No |
| e. To a consumer reporting agency in accordance with the Fair Credit Reporting Act or from a consumer report reported by a consumer reporting agency (§ 216.15(a)(5))   | Yes | No |
| f. In connection with a proposed or actual sale, merger, transfer, or exchange of all or a portion of a business or operating unit, if the disclosure of nonpublic personal information concerns only consumers of such business or unit (§ 216.15(a)(6)) | Yes | No |
| g. To comply with federal, state, or local laws, rules, or legal requirements (§ 216.15(a)(7)(i))   | Yes | No |
| h. To comply with a properly authorized civil, criminal, or regulatory investigation, or a subpoena or summons by federal, state, or local authorities (§ 216.15(a)(7)(ii))   | Yes | No |
| i. To respond to judicial process or government regulatory authorities having jurisdiction over the institution for examination, compliance, or other purposes as authorized by law (§ 216.15(a)(7)(iii))   | Yes | No |

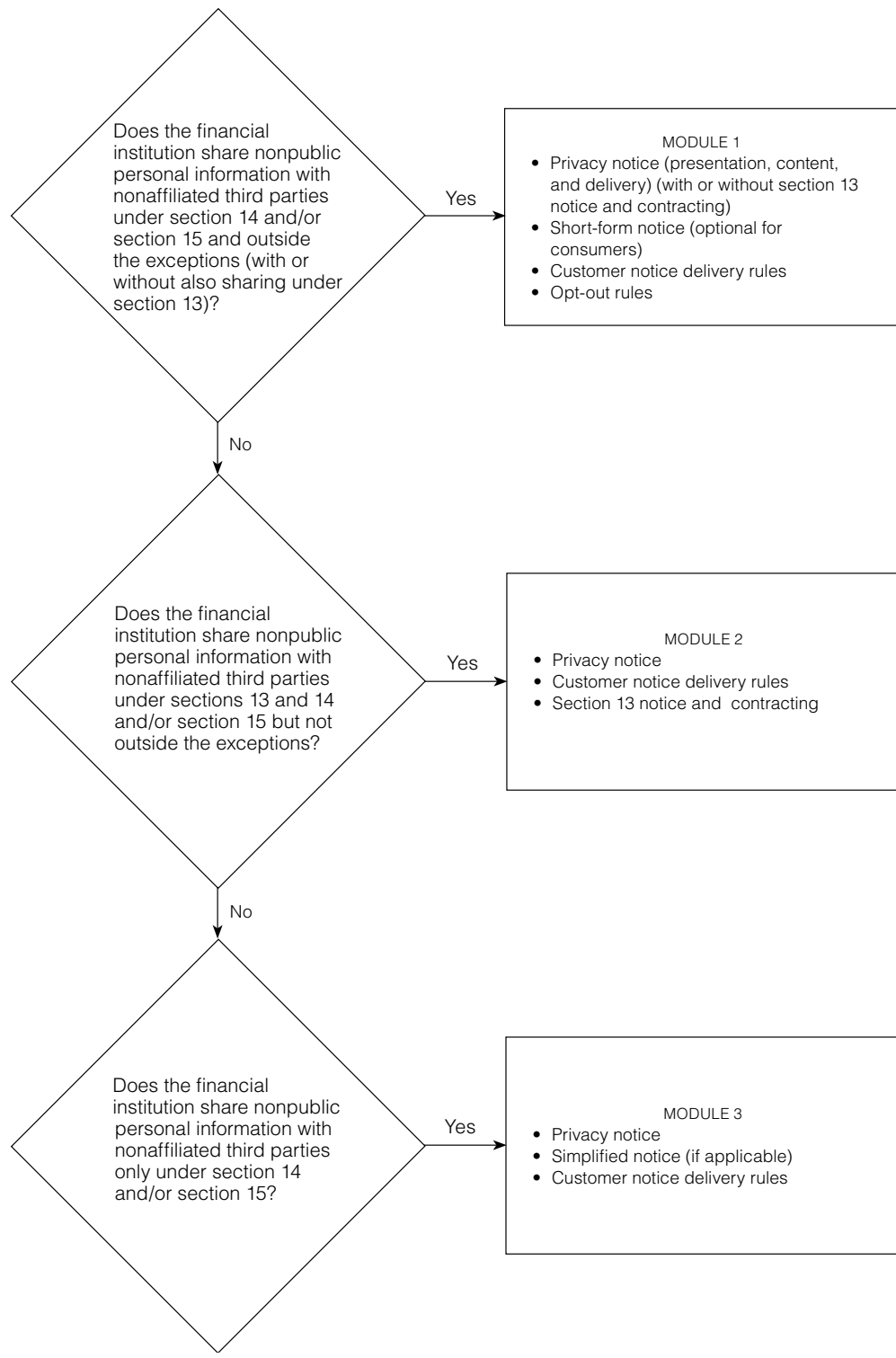
Note: The regulation gives the following as an example of the exception described in part a of this question: “A consumer may specifically consent to disclosure to a nonaffiliated insurance company of the fact that the consumer has applied to [the institution] for a mortgage so that the insurance company can offer homeowner’s insurance to the consumer.”



# Regulation P

## Appendix A. Decision Tree: Privacy Notices and Opt-Out Provisions

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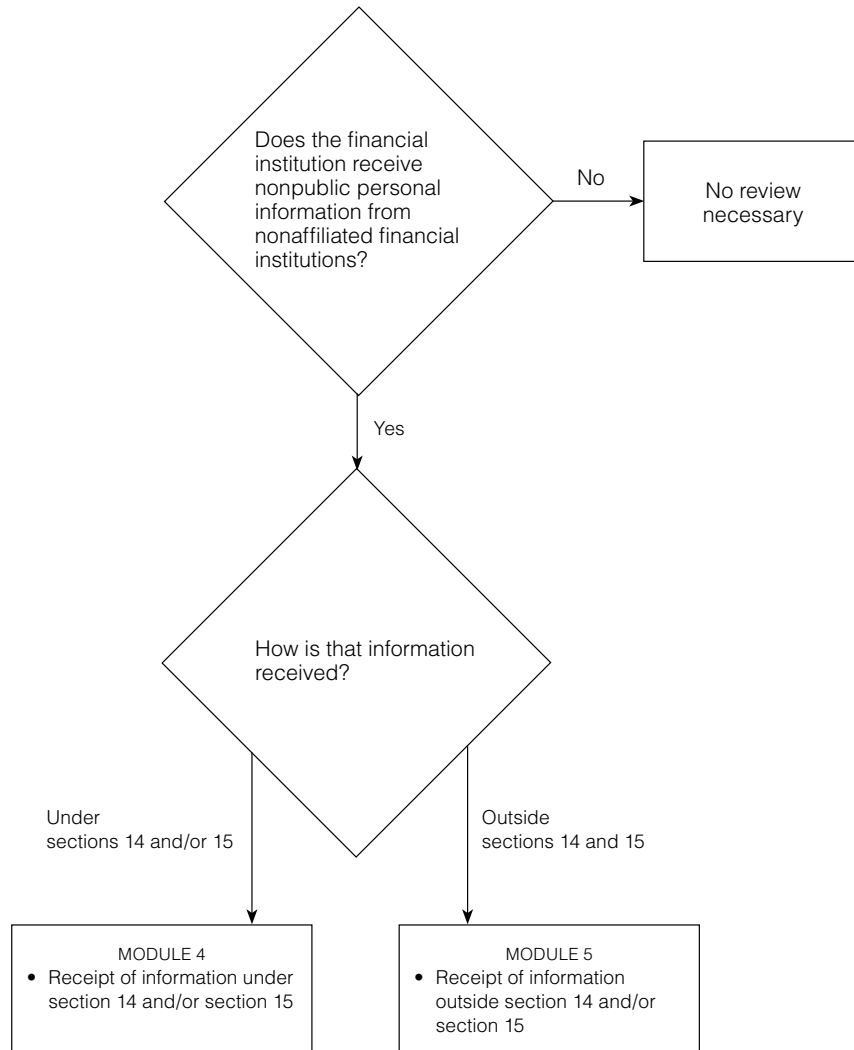


# Regulation P

## Appendix B. Decision Tree: Reuse and Redisclosure of Nonpublic Personal Information Received from Nonaffiliated Financial Institutions

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(Sections 11(a) and 11(b))



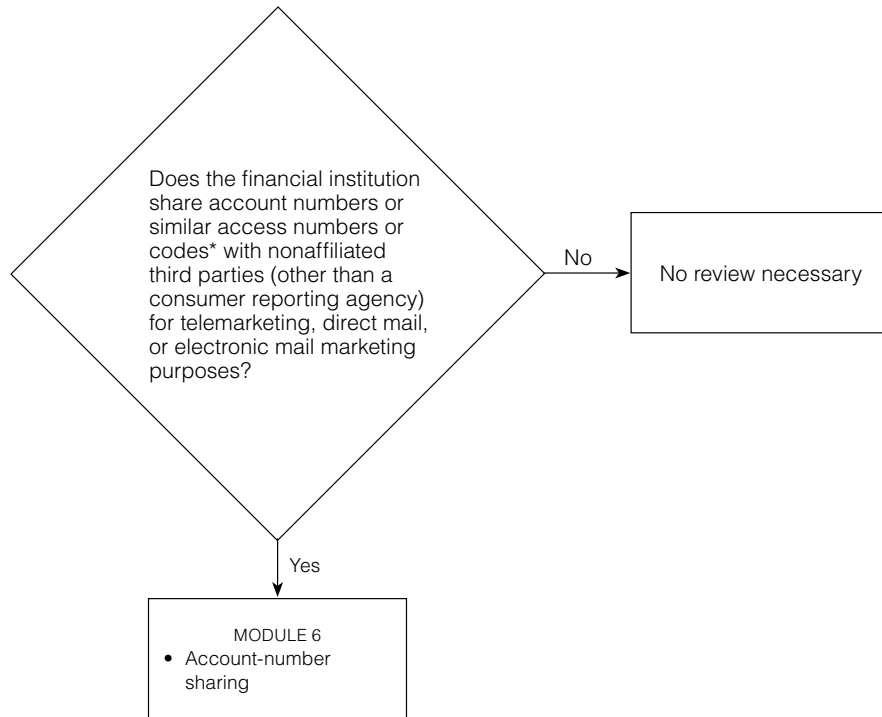


# Regulation P

## Appendix C. Decision Tree: Account-Number Sharing

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(Section 12)



\* Including encrypted account numbers—but not the decryption key.



# Regulation AA

## Unfair or Deceptive Acts or Practices: Credit Practices Rule

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### Background

The Credit Practices Rule, which was adopted by the Federal Reserve Board under section 18(f)(1) of the Federal Trade Commission Act (15 USC 45) in response to a similar rule adopted by the Federal Trade Commission, is contained in subpart B of Regulation AA.<sup>1</sup> It became effective in January 1986.

The rule prohibits banks and their subsidiaries from using (1) certain provisions in their consumer credit contracts, (2) a late-charge accounting practice known as pyramiding, and (3) deceptive cosigner practices. It also requires that a disclosure notice be given to a cosigner prior to the cosigner's becoming obligated. Finally, the rule prohibits banks and their subsidiaries from enforcing in purchased contracts the same provisions they are prohibited from including in their own consumer credit contracts.

### Scope of the Rule

The Credit Practices Rule applies to consumer credit contracts other than those for the purchase of real estate. Dwellings such as mobile homes and houseboats are not considered real estate if they are considered personal property under state law. A *consumer* is defined as a natural person who seeks or acquires goods, services, or money for personal, family, or household purposes. There is no monetary limit on the coverage of the rule.

### Prohibited Contract Provisions

In general, banks are prohibited from entering into credit contracts that contain any of the provisions described in the following paragraphs.

#### Confession of Judgment

A *confession of judgment* is a contract clause (sometimes also known as a cognovit or a warrant of attorney) in which the borrower waives the right to notice and the opportunity to be heard in court in the event of a creditor-initiated lawsuit to enforce an obligation.

The following are not prohibited:

- Confessions executed after default or the filing of a suit on the debt

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1. The Office of Thrift Supervision has a rule for savings banks identical to the Federal Reserve's rule for state member banks and their subsidiaries.

- Powers of attorney contained in a mortgage or deed of trust for foreclosure purposes
- Powers of attorney given to expedite the disposal of repossessed collateral or the transfer of pledged securities
- Confessions in Louisiana for the purpose of executory process

#### Waiver of Exemption

Under a *waiver of exemption*, a consumer relinquishes the right granted under state law to protect his or her home (a right known as the homestead exemption), possessions, or wages from seizure to satisfy a judgment. Under the rule, a waiver is permitted if it pertains solely to the property given as collateral in connection with a consumer credit obligation.

Any other types of waivers (for example, waivers of demand, presentment, protest, notice of dishonor, and notice of protest) are not prohibited.

#### Assignment of Wages

An *assignment of wages* is a contract provision that gives banks the right to receive the consumer's future wages or earnings directly from the consumer's employer in the event the consumer defaults on the loan.

The following are not prohibited:

- An assignment that by its terms is revocable at will by the consumer
- A payroll deduction or preauthorized-payment plan (whether or not revocable by the consumer) commencing at loan consummation and authorized for the purpose of making periodic payments on the debt
- A revocable preauthorized-payment plan (subject to the Electronic Fund Transfer Act) for electronic fund transfers to accounts from wages
- An assignment of wages already earned at the time of the assignment
- Garnishment

*Earnings* are defined as compensation paid or payable to an individual, or for the individual's account, for personal services rendered or to be rendered by the consumer, whether in the form of wages, salary, commission, or bonus, including periodic payments pursuant to a pension, retirement, or disability program.

## Security Interest in Household Goods

A nonpossessory security interest in household goods is prohibited unless such goods are purchased with credit extended by the financial institution.

The following are not prohibited:

- Security interests in household goods not purchased with credit extended by the bank if the goods are placed in the bank's possession
- Security interests in all other real and personal property of the consumer other than household goods as defined in the rule

*Household goods* include the clothing, furniture, appliances, linens, china, crockery, kitchenware, and personal effects of the consumer and the consumer's dependents. The following are not household goods:

- Works of art
- Electronic equipment (other than one television and one radio)
- Items acquired as antiques, including such items that have been repaired or renovated without changing their original form or character (To be considered an antique, an item must be more than 100 years old.)
- Jewelry (other than wedding rings)
- Automobiles, boats, snowmobiles, cameras and camera equipment (including darkroom), pianos, home workshops, and the like

## Examples of Prohibited Contract Provisions

### *Confession of Judgment*

- *If you fail to carry out the terms of this notice, you appoint \_\_\_\_\_ or \_\_\_\_\_ as your attorney-in-fact for the purpose of confessing judgment against you, and you authorize either of them to confess judgment against you in favor of us in the Clerk's Office of the City/County of Powhatan, Virginia, or in any other court of proper jurisdiction for the unpaid balance of this Note plus costs, expenses, and attorney's fees as provided on the reverse side of this Note.*
- *You and any CoMaker, jointly and severally, authorize the Prothonotary, Clerk, and any attorney of any court of record to appear for you and any CoMaker and confess judgment in our favor or in favor of any other holder of this Note. Judgment by confession may be entered either prior to or after an event of default, as often as necessary, for such sums as are or may become due on this Note, with costs of suit and 20 percent added as actual and reasonable*

*attorney's fees. You and CoMaker agree, to the extent permitted by law, to all rights of appeal, appraisal, stay of execution, and exemption now or later enforced. If a copy of this Note is filed in connection with the entry of judgment, it shall not be necessary to file the original Note as a Warrant of Attorney, if the copy is verified by affidavit.*

### *Waiver of Exemption*

- *I waive my homestead exemption.*
- *In consideration of the credit extended, Mortgagor waives and relinquishes, with respect to the Property and all other property now or hereafter owned by Mortgagor, the benefit of any and all stay and extension laws, and further expressly waives notice and delay accorded by Louisiana Code of Civil Procedure Articles 2331, 2639, and 2722 and La. R. S. 12:4363–4366, including, but not limited to, any and all homestead and other claims to exemption from seizure that under existing or future laws might be asserted against enforcement of payment of the indebtedness secured hereby, and consents to the immediate seizure, advertisement, and sale of said property in the event of institution of executory or other legal proceedings.*
- *Debtor hereby acknowledges express intent to hereby waive and abandon all personal property exemptions granted by law upon the goods, which are the subject of this Agreement. Notice: By signing this Agreement, Debtor waives all rights provided by law to claim such goods exempt from process.*
- *I waive (to the extent permitted by law) certain rights I might otherwise have. All exemptions in and to any of the property are hereby waived.*

## Prohibited Practices

### Pyramiding of Late Charges

Pyramiding is an accounting method that results in the assessment of multiple delinquency charges as a consequence of a single delinquent payment for the current month. For example, when a borrower's payment is received late, the lender deducts a late charge directly from the payment received, which then results in an insufficient payment. Although the next payment may be received on time, because the first payment was considered insufficient, a late charge is again applied. This continues until either the borrower pays the late charge separately or the loan matures. The examiner should not confuse this situation with one in which a payment is missed and never made up, triggering late charges each month until the entire payment is made and the account is brought entirely up to date or is paid in full.

## Cosigner Deception

The institution may not misrepresent the nature and extent of a cosigner's liability to any person.

## Disclosures to Cosigners

A financial institution must provide, either in a separate document or in the credit obligation, a clear and conspicuous notice that is substantially similar to the example below. This notice must be given to the cosigner prior to the time he or she becomes obligated. In the case of open-end credit plans, the notice must be given prior to the time the cosigner becomes obligated for fees or transactions on the account.

### *Sample Notice to Cosigner*

*You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay the debt if you have to, and that you want to accept this responsibility.*

*You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which may increase this amount.*

*The bank can collect this debt from you without first trying to collect from the borrower. The bank can use the same collection methods against you that can be used against the borrower, such as suing you or garnishing your wages. If this debt is ever in default, that fact may become a part of your credit record.*

*This notice is not the contract that makes you liable for the debt.*

A *cosigner* is defined as

- Any person who assumes personal liability, in any capacity, for the obligation of another

consumer without receiving goods, services, or money in return for the obligation. This includes any person whose signature is requested to allow a consumer to obtain credit or to prevent collection of a consumer's obligation that is in default.

- A person who meets the above definition, whether or not he or she is designated as such in the contract
- For open-end credit, a person who signs the debt instrument but does not have the contractual right to obtain credit under the account

A cosigner is not

- A spouse whose signature is required on a credit obligation to perfect a security interest pursuant to state law
- A person who does not assume personal liability, but rather only provides collateral for the obligation of another person
- A person who has the contractual right to obtain credit under an open-end account, whether exercised or not

## Civil Liability

There is no express provision for civil liability in either the Federal Trade Commission Act or Regulation AA.

## Administrative Enforcement

Regulation AA is to be enforced for banks through section 8 of the Federal Deposit Insurance Act (12 USC 1818). In addition, the Federal Reserve may enforce compliance through any other authority conferred on it by law (15 USC 57a(f)(4)).





# Regulation AA

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

1. To determine if the financial institution has established an effective system for ensuring that it
  - a. Does not originate, acquire, or enforce contracts that contain prohibited provisions
  - b. Does not “pyramid” late charges
  - c. Does not engage in deceptive cosigner practices
  - d. Provides the required disclosure to cosigners prior to their becoming obligated
2. To determine whether the credit contracts originated or purchased by the institution contain prohibited provisions
3. To determine whether the institution used impermissible late-charge accounting practices
4. To determine if the institution advised cosigners prior to their becoming contractually liable of the nature and extent of their liability
5. To determine if the institution provides the required notices to cosigners prior to their becoming obligated or, in the case of open-end credit plans, prior to the time they become obligated for fees or transactions on the account
6. To determine if the institution has attempted to enforce prohibited provisions in contracts it has originated or acquired

### EXAMINATION PROCEDURES

1. Obtain and review blank notes (contracts) and disclosures (including those furnished to dealers) used by the financial institution in extending consumer credit for the following prohibited contract provisions:
  - a. Confession of judgment—A waiver by the consumer of the right to notice and the opportunity to be heard in court in the event of a suit on the obligation (§ 227.13(a))
  - b. Waiver of statutory property exemption—A waiver by the consumer of the statutory right to protect his or her home (known as the homestead exemption), possessions, or wages from seizure to satisfy a judgment unless the waiver is given on property that will serve as security for the obligation (§ 227.13(b))
  - c. Assignment of wages—A provision giving the bank the right to receive the consumer’s wages or earnings directly from the con-

sumer’s employer (§ 227.13(c)). However, such an assignment is permitted if

- i. It is revocable at will by the consumer
  - ii. It is a payroll deduction plan or a pre-authorized payment plan (whether or not revocable by the consumer), commencing at consummation, for the purpose of making loan payments
  - iii. It applies only to wages or earnings already earned at the time of the assignment
  - d. Blanket security interest in household goods—A provision that allows the institution to hold as collateral the clothing, furniture, appliances, and personal effects of the consumer’s dependents (§ 227.13(d))
2. Determine through discussions with management and staff if the institution attempts to enforce confessions of judgment, waivers of exemption, assignments of wages, or security interests in household goods in originated or acquired contracts.
  3. Review the bank’s collection policies, procedures, and practices to ensure that staff members are not using an assignment of wages except where permissible. (§ 227.13(c))
  4. Judgmentally sample an adequate number of loan files to ensure that prohibited contract provisions are not included in contracts (or related documents) originated by, or enforced in contracts acquired by, the institution.
  5. Judgmentally sample an adequate number of overdue loans to determine if the institution collects or attempts to collect overdue payments through assignment of wages. (§ 227.13(c))
  6. Judgmentally sample an adequate number of overdue loans to determine if the institution collects or attempts to collect a late charge on a timely payment because of the consumer’s failure to pay a late charge attributable to a prior delinquent payment. (§ 227.15))
  7. Determine through a review of procedures, policies, and practices whether the institution takes steps to prevent its staff from engaging in prohibited cosigner practices on loans it originated or acquired. (§ 227.14(a))
  8. Determine through discussions with management and staff if there is evidence that the institution engages in prohibited cosigner practices (for example, misrepresenting a cosign-

- er's liability or contractually obligating cosigners prior to informing them of their liability).
9. Determine through discussions with management and staff whether the nature and extent of a cosigner's liability is properly represented to cosigners prior to the time signatures are obtained. (§ 227.14(a))
  10. Judgmentally sample the documents evidencing the credit obligation and determine if they contain the required notice to cosigners. (§ 227.14(b))
    - a. If the notice to cosigners is contained in the note or disclosure, it must be clear, conspicuous, and substantially similar to that provided in the regulation and must be provided before the cosigner becomes obligated.
    - b. If the notice to cosigners is contained in a separate document, also
      - i. Interview applicable employees to determine if they are aware that the notice must be provided prior to the cosigner's becoming obligated.
      - ii. Review the institution's policies, procedures, and practices to ensure that staff members are aware that cosigners must be provided with the notice prior to their becoming obligated.

# Regulation AA Examination Checklist

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- |  |     |    |
|--|-----|----|
| 1. Do the consumer contracts originated by the bank contain any of the following prohibited provisions?  |     |    |
| a. Confession of judgment (§ 227.13(a))  | Yes | No |
| b. Waiver of statutory property exemption (unless the waiver applies solely to the property that will serve as security for the loan) (§ 227.13(b))  | Yes | No |
| c. Assignment of wages or other earnings (except where permitted) (§ 227.13(c))  | Yes | No |
| d. Blanket security interests in household goods (§ 227.13(d))   | Yes | No |
| 2. Does the bank acquire loans originated by other creditors?  | Yes | No |
| If so, does it attempt to enforce any of the following prohibited practices?   |     |    |
| a. Confession of judgment (§ 227.13(a))  | Yes | No |
| b. Waiver of statutory property exemption (unless the waiver applies solely to the property that will serve as security for the loan) (§ 227.13(b))  | Yes | No |
| c. Assignment of wages or other earnings (except where permitted) (§ 227.13(c))  | Yes | No |
| d. Blanket security interests in household goods (§ 227.13(d))   | Yes | No |
| 3. Does the bank take a nonpossessory security interest in household goods (as defined in section 227.12(d)) not purchased with the loan proceeds? (Review bank security agreement forms.)                                       | Yes | No |
| 4. Has the bank attempted to enforce any prohibited practices with respect to the consumer credit contracts it has originated? (§ 227.13(a) or 227.13(b))  | Yes | No |
| 5. Does the bank collect or attempt to collect a late charge on a timely payment because of the consumer's failure to pay a late charge attributable to a prior delinquent payment? (§ 227.15)                                   | Yes | No |
| 6. Has the bank engaged in any prohibited cosigner practices (for example, misrepresenting the cosigner's liability or obligating cosigners prior to providing the required notification)? (§ 227.14(a))                         | Yes | No |
| 7. Does the bank provide to each cosigner, prior to his or her becoming contractually obligated, the required notice or one that is substantially similar (whether separate or contained in the credit documents)? (§ 227.14(b)) | Yes | No |



# Federal Trade Commission Act

## Section 5: Unfair or Deceptive Acts or Practices

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### Background

Section 5 of the Federal Trade Commission Act (FTC Act) (15 USC 45) prohibits “unfair or deceptive acts or practices in or affecting commerce.” The prohibition applies to all persons engaged in commerce, including banks. Under section 8 of the Federal Deposit Insurance Act, the Board has the authority to take appropriate action when unfair or deceptive acts or practices are discovered.

Responsibilities for enforcing the prohibition against unfair or deceptive practices as they apply to state-chartered banks are spelled out in a joint statement issued on March 11, 2004, by the Board and the Federal Deposit Insurance Corporation. That statement, which is included as an appendix to this chapter, describes in depth the legal standards for unfair and deceptive acts or practices, discusses the management of risks relating to unfair or deceptive acts or practices, and provides general guidance on measures that state-chartered banks can take to avoid engaging in such acts or practices, including best practices.

### Legal Standards

The legal standards for unfairness and deception are independent of each other; depending on the facts, an act or practice may be unfair, deceptive, or both. The legal standards are briefly described here.

#### Unfair Acts or Practices

An act or practice is unfair where it

- Causes or is likely to cause substantial injury to consumers,
- Cannot be reasonably avoided by consumers, and
- Is not outweighed by countervailing benefits to consumers or to competition.

Public policy, as established by statute, regulation, or judicial decisions, may be considered with all other evidence in determining whether an act or practice is unfair.

#### Deceptive Acts or Practices

An act or practice is deceptive where

- A representation, omission, or practice misleads or is likely to mislead the consumer;

- A consumer’s interpretation of the representation, omission, or practice is considered reasonable under the circumstances; and
- The misleading representation, omission, or practice is material.

### Relationship of Section 5 to Other Laws and Ratings

Some acts or practices may violate both section 5 of the FTC Act and other federal or state laws. Other acts or practices may violate only the FTC Act while fully complying with other consumer protection laws and regulations. If a possible violation of the FTC Act is found, the examiner should consider whether other statutory or regulatory violations have occurred (the joint statement identifies laws that warrant particular attention in this regard).

In addition, if an illegal credit practice is identified through a review of FTC Act compliance, the examiner should consider whether the illegal practice would adversely affect the institution’s Community Reinvestment Act rating pursuant to the regulatory requirements of 12 CFR 228.28(c).

### Compliance Risk Evaluation

Violations of section 5 of the FTC Act can present significant legal, reputational, and compliance risks for banks. This possibility intensifies the need for examiners to assess compliance with section 5 in conjunction with consumer compliance examinations, related supervisory activities, and consumer complaint investigations. Consistent with the Board’s risk-focused consumer compliance supervision program, the need to assess compliance with section 5 should be considered when developing risk assessments, scoping an examination, or investigating a consumer complaint.

A determination about whether a particular act or practice is unfair or deceptive will depend on an analysis of the facts and circumstances. Although individual violations or complaints may appear isolated, they may, when considered in the context of additional information, including other violations or complaints, raise concerns about unfair or deceptive acts or practices.

Furthermore, the prohibition against unfair or deceptive acts or practices applies not only to all products and services offered by a bank, but to every stage and activity, from product develop-

ment to the creation and rollout of marketing campaigns, and to servicing and collections. Therefore, particular attention should be paid to

new or modified systems or products and to third-party arrangements.

# Federal Trade Commission Act—Section 5

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

- To determine the adequacy of the bank's internal procedures, policies, and controls to ensure consistent compliance with section 5 of the FTC Act
- To determine if the bank complies with section 5 of the FTC Act, which prohibits unfair or deceptive acts or practices

### EXAMINATION PROCEDURES

To fulfill the examination objectives, and consistent with the joint statement in the appendix to this chapter, examiners should identify the bank's internal policies, procedures, and controls to be reviewed for compliance with section 5 of the FTC Act. In particular, the bank's compliance management systems, advertising and promotional materials, initial and subsequent disclosures, servicing and collections, and management and monitoring of employees and third parties should be reviewed as they relate to the products and services identified as potential areas of concern.

Examiners also should use these procedures in conjunction with the guidance and best practices contained in the joint statement to determine whether an unfair or deceptive act or practice has occurred. Specifically, examiners should, as appropriate,

- Review previous examinations reports, including consumer compliance and safety-and-soundness examination reports;
- Review current and prior examination findings regarding the institution's compliance with Regulation AA (Unfair or Deceptive Acts or Practices; Credit Practices Rules);<sup>1</sup>
- Review the bank's policies, procedures, and internal controls;
- Review a sample of consumer complaints, advertisements and promotional materials, disclosures, customer agreements, and third-party contracts and instructions;
- Interview management and staff about the bank's acts and practices; and

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1. See the examination procedures for Regulation AA elsewhere in this handbook. Regulation AA applies to consumer credit contracts other than those for the purchase of real estate. It prohibits banks and their subsidiaries from using (1) certain provisions in their consumer credit contracts, (2) a late-charge accounting practice known as pyramiding, and (3) deceptive cosigner practices.

- Discuss any examiner concerns with bank management.

### Evaluating Compliance Management Programs

A bank's compliance management program should focus on the avoidance of acts or practices that are unfair or deceptive and on the prompt correction of any such identified acts or practices. The degree of specificity with which a compliance management program should address this area will vary depending on the bank's size, complexity, and product offerings. A small bank that offers a limited number of products through a few branches may not need the kind of specific, documented compliance program needed by a bank engaged in, for example, nationwide mortgage or credit card lending.

### Items to Evaluate

1. Determine whether the bank's policies and procedures include guidance on preventing unfair or deceptive acts or practices.
2. Ascertain whether the bank reviews its practices in the context of federal regulations, policies, and decisions on unfair or deceptive acts or practices.
3. Ascertain whether the bank's compliance management function looks beyond the identification of individual violations to determine if its practices may be unfair or deceptive.
4. Determine whether the bank trains its employees on the provisions of the FTC Act that prohibit unfair or deceptive acts or practices.
5. Determine whether the bank reviews consumer complaints to identify potential compliance problems and negative trends that have the potential to be unfair or deceptive. Determine whether the bank reviews concentrations of complaints about the same product or about bank conduct in order to identify potential areas of concern.
6. Determine whether the bank has identified any potentially unfair or deceptive acts or practices and, if it has, verify that it corrected the identified concerns and provided restitution to affected persons when appropriate.
7. If the bank has identified potentially unfair or deceptive acts or practices, determine if it has implemented changes to prevent future recurrences.



8. Determine whether the bank clearly discloses a telephone number or mailing address (and an e-mail address or website if applicable) that consumers may use to contact the bank or its third-party servicers regarding any complaints or inquiries they may have.
9. Determine whether the bank's management is involved both in the development of new products and services and in decisions to reprice or change the terms of existing products and services.

## Evaluating Advertising and Promotional Materials

Because of the increasing complexity of certain products, particularly mortgage loans and credit cards, a bank's advertising and promotional materials should be presented in a clear, balanced, and timely manner, with special attention paid to products targeted toward the elderly, financially vulnerable, or financially unsophisticated.<sup>2</sup> Advertising and promotional materials should present not only the benefits of the products and services, but also any potential risks, such as payment shock or negative amortization. When a bank's business is driven largely by product marketing and promotion, it should exercise particular caution to avoid potentially unfair or deceptive acts or practices.

### Items to Evaluate

1. Determine whether the bank reviews all advertisements, promotional materials, and marketing scripts to ensure that there is a reasonable factual basis for all representations made.
2. Determine whether the bank reviews all advertisements, promotional materials, and marketing scripts to ensure that these materials do not use fine print, separate statements, or inconspicuous disclosures to correct potentially misleading headlines.
3. Determine whether the bank tailors advertisements, promotional materials, and marketing scripts to take into account the sophistication and experience of the target audience, including the elderly and financially vulnerable.
4. Determine whether the bank (or its third-party servicer), in advertisements, promotional materials, marketing scripts, and recorded telephone conversations, makes claims, representations, or statements that may mislead members of the target audience about the cost,

value, availability, cost savings, benefits, or terms of the product or service.

5. Determine whether the bank reviews all advertisements, promotional materials, and marketing scripts to ensure that they fairly and adequately describe the terms, benefits, and material limitations of the product or service being offered, including any related or optional products or services, and that they do not misrepresent such terms either affirmatively or by omission.
6. Determine whether the bank avoids advertising that a particular service or benefit will be provided in connection with an account if the bank does not intend or is not able to provide the service or benefit to account holders.
7. Determine whether the bank draws the attention of customers to key terms, including limitations and conditions that are important in enabling customers to make informed decisions about whether the product or service meets their needs.
8. Determine whether the bank, when using such terms as "pre-approved," "guaranteed," or "fixed rates," clearly discloses any limitations, conditions, or restrictions on the offer.
9. Determine whether the bank ensures that the costs and benefits of related or optional products and services, such as overdraft protection, are clearly explained and are not misrepresented or presented in an incomplete or overly complex manner.
10. Determine whether the bank avoids advertising terms that are not available to most customers and avoids using unrepresentative examples in advertising, marketing, and promotional materials.
11. Determine whether the bank reviews its website content and navigational process to ensure that consumers are able to readily obtain the necessary disclosures for its products.
12. Determine whether the bank reviews its advertising and promotional materials to avoid raising concerns about unfair or deceptive acts or practices.

## Evaluating Initial and Subsequent Disclosures

A bank's disclosures with respect to initial terms and conditions, repricing, and changes in terms should be clear and accurate. The terms and conditions of many credit and deposit products are variable and may change periodically on the basis of external variables, such as changes in the prime rate. Many credit card products have terms that

<sup>2</sup> Advertising and promotional materials include print and electronic materials as well as scripts used for radio, Internet, or television advertising and telemarketing.

may change or increase automatically following a specific event, such as an interest rate increase triggered by a consumer's delinquency with the creditor or another creditor. The disclosures for products such as these—products having variable terms and conditions—should be clearly presented.

### Items to Evaluate

1. Determine whether the bank reviews all customer agreements and disclosures to ensure that there is a reasonable factual basis for all representations made.
2. Determine whether the bank's customer agreements and disclosures fairly and adequately describe the terms, benefits, and material limitations or conditions of the product or service being offered. Limitations may take the form of, for example, limited applicability (for instance, a special interest rate that applies only to balance transfers), limited duration (for instance, an expiration date for terms that apply only during an introductory period), or a prerequisite for obtaining particular terms (for instance, minimum transaction amounts or introductory or other fees). Conditions may include, for example, the consumer's ability to cancel a service without a charge.
3. Determine whether the bank's disclosures make claims, representations, or statements that may mislead members of the target audience about the cost, value, availability, cost savings, benefits, or terms of the product or service.
4. Determine whether the bank informs consumers in a clear and timely manner about any fees, penalties, or other charges that have been imposed (including charges for any force-placed products), and the reasons for their imposition.
5. Determine whether the bank clearly discloses that optional or related products and services that are offered simultaneously with credit—such as insurance, travel services, credit protection, and consumer report update services—are not required as a prerequisite to obtaining credit or are not considered in decisions to grant credit.
6. Determine whether the bank, when making claims about amounts of credit available to consumers, accurately and completely represents the amount of potential, approved, or usable credit that the consumer will receive.
7. Determine whether the bank clearly informs a consumer when the account terms approved for the consumer are less favorable than the terms advertised or previously disclosed.
8. If the bank reserves the right to change the

terms of an account or product, determine whether the bank's customer agreements clearly disclose that the bank may make future changes to the rate, terms, and conditions otherwise specified in any agreement signed by or given to the consumer. Determine whether the circumstances under which such changes may be made are clearly explained.

## Evaluating Servicing and Collections

Servicing and collection activities present a greater risk of potential violations of section 5 of the FTC Act when conducted by affiliates or third-party vendors and servicers. Thus, a bank should ensure that the disclosures provided for these servicing and collection activities are accurate and not misleading. The bank should also ensure that the activities are conducted fairly and in consonance with any disclosures or agreements. For example, statements should clearly indicate when payments are due if penalties are to be avoided.

### Items to Evaluate

1. Determine whether the bank ensures that its employees and third-party servicers have, and follow, procedures to credit consumer payments in a timely manner.
2. Determine whether consumers are clearly told when and if monthly payments are applied to fees, penalties, or other charges before being applied to regular principal and interest.
3. Determine whether account statements clearly disclose how fees, penalties, other charges, and interest and principal payments affect the account balance and whether these charges and payments have been calculated in accordance with any written agreements with the borrower.

## Monitoring the Conduct of Employees and Third Parties

A bank should have effective controls in place for hiring personnel and for contracting and maintaining relationships with third parties. The controls should, for example, establish responsibilities vis-a-vis third parties for training and monitoring staff. The controls should also foster the bank's ability to monitor the actual practices of its employees and third-party contractors and ensure that these practices are consistent with the bank's policies and procedures, applicable laws and regulations, and third-party agreements. In addition, the bank's monitoring should include a review of training and promotional materials used by its employees and by third parties, to ensure that any concerns about

unfair or deceptive acts or practices are identified early.

### Items to Evaluate

1. Determine whether, through its third-party agreements and internal policies, the bank has effective controls for monitoring risks associated with selecting and managing third-party contractors. Such agreements and policies should outline the degree of monitoring, acceptable error rates, and corrective action provisions in case of noncompliance. They also should identify issues that would need to be brought to the attention of bank management.
2. Determine whether the bank's compensation programs for employees and third-party contractors provide incentives for acts or practices that could raise potential concerns, such as compensation programs that steer consumers to particular products to the exclusion of other, potentially beneficial products.
3. Determine whether the bank monitors the training of employees and third parties who market or promote bank products or service loans, to ensure that they are adequately trained to avoid making statements or taking actions that might be unfair or deceptive. Monitoring should include a review of training and promotional materials, including telemarketing scripts.
4. Determine whether the bank monitors a third party's primary interface with consumers by, for example, reviewing recorded telephone calls or transcripts of online communications.

# Federal Trade Commission Act—Section 5

## Appendix: Statement on Unfair or Deceptive Acts or Practices by State-Chartered Banks

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*The following statement was issued jointly by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation on March 11, 2004.*

### Purpose

The Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (the Board and the FDIC, or, collectively, the agencies) are issuing this statement to outline the standards that will be considered by the agencies as they carry out their responsibility to enforce the prohibitions against unfair or deceptive trade practices found in section 5 of the Federal Trade Commission Act (FTC Act)<sup>3</sup> as they apply to acts and practices of state-chartered banks. The agencies will apply these standards when weighing the need to take supervisory and enforcement actions and when seeking to ensure that unfair or deceptive practices do not recur.

This statement also contains a section on managing risks relating to unfair or deceptive acts or practices that includes best practices, as well as general guidance on measures that state-chartered banks can take to avoid engaging in such acts or practices.

Although the majority of insured banks adhere to a high level of professional conduct, banks must remain vigilant against possible unfair or deceptive acts or practices both to protect consumers and to minimize their own risks.

### Coordination of Enforcement Efforts

Section 5(a) of the FTC Act prohibits “unfair or deceptive acts or practices in or affecting commerce”<sup>4</sup> and applies to all persons engaged in commerce, including banks. The agencies each have affirmed their authority under section 8 of the Federal Deposit Insurance Act to take appropriate action when unfair or deceptive acts or practices are discovered.<sup>5</sup>

A number of regulators have authority to combat unfair or deceptive acts or practices. For

3. 15 USC 45.

4. 15 USC 45(a).

5. 12 USC 1818(b)(1), (e)(1), and (i)(2). See letter from Chairman Alan Greenspan to the Hon. John J. LaFalce (May 30, 2002) and “Unfair or Deceptive Acts or Practices: Applicability of the Federal Trade Commission Act,” FIL 57-2002 (May 30, 2002).

example, the Federal Trade Commission has broad authority to enforce the requirements of section 5 of the FTC Act against many non-bank entities.<sup>6</sup> In addition, state authorities have primary responsibility for enforcing state statutes against unfair or deceptive acts or practices. The agencies intend to work with these other regulators as appropriate in investigating and responding to allegations of unfair or deceptive acts or practices that involve state banks and other entities supervised by the agencies.

### Standards for Determining What Is Unfair or Deceptive

The FTC Act prohibits unfair or deceptive acts or practices. Congress drafted this provision broadly in order to provide sufficient flexibility in the law to address changes in the market and unfair or deceptive practices that may emerge.<sup>7</sup>

An act or practice may be found to be *unfair* where it “causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.”<sup>8</sup> A representation, omission, or practice is *deceptive* if it is likely to mislead a consumer acting reasonably under the circumstances and is likely to affect a consumer’s conduct or decision regarding a product or service.

The standards for unfairness and deception are independent of each other. While a specific act or practice may be both unfair and deceptive, an act or practice is prohibited by the FTC Act if it is *either* unfair *or* deceptive. Whether an act or practice is unfair or deceptive will in each instance depend upon a careful analysis of the facts and circumstances. In analyzing a particular act or practice, the agencies will be guided by the body of law and official interpretations for defining unfair or deceptive acts or practices developed by the courts and the FTC. The agencies will also consider factually similar cases brought by the

6. 15 USC 45(a)(2) and Gramm–Leach–Bliley Act, section 133, published in notes to 15 USC 41.

7. See FTC Policy Statement on Unfairness (December 17, 1980) and FTC Policy Statement on Deception (October 14, 1983).

8. This standard was first issued as a policy by the FTC and later codified into the FTC Act as 15 USC 45(n).

FTC and other regulators to ensure that these standards are applied consistently.

## Unfair Acts or Practices

### Assessing Whether an Act or Practice Is Unfair

An act or practice is unfair where it (1) causes or is likely to cause substantial injury to consumers, (2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition. Public policy may also be considered in the analysis of whether a particular act or practice is unfair. Each of these elements is discussed further below.

- *The act or practice must cause or be likely to cause substantial injury to consumers*—To be unfair, an act or practice must cause or be likely to cause substantial injury to consumers. Substantial injury usually involves monetary harm. An act or practice that causes a small amount of harm to a large number of people may be deemed to cause substantial injury. An injury may be substantial if it raises a significant risk of concrete harm. Trivial or merely speculative harms are typically insufficient for a finding of substantial injury. Emotional impact and other more subjective types of harm will not ordinarily make a practice unfair.
- *Consumers must not reasonably be able to avoid the injury*—A practice is not considered unfair if consumers may reasonably avoid injury. Consumers cannot reasonably avoid injury from an act or practice if it interferes with their ability to effectively make decisions. Withholding material price information until after the consumer has committed to purchase the product or service would be an example of preventing a consumer from making an informed decision. A practice may also be unfair where consumers are subject to undue influence or are coerced into purchasing unwanted products or services.

The agencies will not second-guess the wisdom of particular consumer decisions. Instead, the agencies will consider whether a bank's behavior unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision making.

- *The injury must not be outweighed by countervailing benefits to consumers or to competition*—To be unfair, the act or practice must be injurious in its net effects—that is, the injury must not be outweighed by any offsetting consumer or competitive benefits that are also produced by the act or practice. Offsetting benefits may include lower prices or a wider availability of products and services.

Costs that would be incurred for remedies or measures to prevent the injury are also taken into account in determining whether an act or practice is unfair. These costs may include the costs to the bank in taking preventive measures and the costs to society as a whole of any increased burden and similar matters.

- *Public policy may be considered*—Public policy, as established by statute, regulation, or judicial decisions, may be considered with all other evidence in determining whether an act or practice is unfair. For example, the fact that a particular lending practice violates a state law or a banking regulation may be considered as evidence in determining whether the act or practice is unfair. Conversely, the fact that a particular practice is affirmatively allowed by statute may be considered as evidence that the practice is not unfair. Public policy considerations by themselves, however, will not serve as the primary basis for determining that an act or practice is unfair.

## Deceptive Acts and Practices

### Assessing Whether an Act or Practice Is Deceptive

A three-part test is used to determine whether a representation, omission, or practice is “deceptive.” First, the representation, omission, or practice must mislead or be likely to mislead the consumer. Second, the consumer's interpretation of the representation, omission, or practice must be reasonable under the circumstances. Lastly, the misleading representation, omission, or practice must be material. Each of these elements is discussed below in greater detail.

- *There must be a representation, omission, or practice that misleads or is likely to mislead the consumer*—An act or practice may be found to be deceptive if there is a representation, omission, or practice that misleads or is likely to mislead the consumer. Deception is not limited to situations in which a consumer has already been misled. Instead, an act or practice may be found to be deceptive if it is likely to mislead consumers. A representation may be in the form of express or implied claims or promises and may be written or oral. Omission of information may be deceptive if disclosure of the omitted information is necessary to prevent a consumer from being misled.

In determining whether an individual statement, representation, or omission is misleading, the statement, representation, or omission will not be evaluated in isolation. The agencies will evaluate it in the context of the entire adver-

tisement, transaction, or course of dealing to determine whether it constitutes deception. Acts or practices that have the potential to be deceptive include making misleading cost or price claims; using bait-and-switch techniques; offering to provide a product or service that is not in fact available; omitting material limitations or conditions from an offer; selling a product unfit for the purposes for which it is sold; and failing to provide promised services.

- *The act or practice must be considered from the perspective of the reasonable consumer*—In determining whether an act or practice is misleading, the consumer’s interpretation of or reaction to the representation, omission, or practice must be reasonable under the circumstances. The test is whether the consumer’s expectations or interpretation are reasonable in light of the claims made. When representations or marketing practices are targeted to a specific audience, such as the elderly or the financially unsophisticated, the standard is based upon the effects of the act or practice on a reasonable member of that group.

If a representation conveys two or more meanings to reasonable consumers and one meaning is misleading, the representation may be deceptive. Moreover, a consumer’s interpretation or reaction may indicate that an act or practice is deceptive under the circumstances, even if the consumer’s interpretation is not shared by a majority of the consumers in the relevant class, so long as a significant minority of such consumers is misled.

In evaluating whether a representation, omission, or practice is deceptive, the agencies will look at the entire advertisement, transaction, or course of dealing to determine how a reasonable consumer would respond. Written disclosures may be insufficient to correct a misleading statement or representation, particularly where the consumer is directed away from qualifying limitations in the text or is counseled that reading the disclosures is unnecessary. Likewise, oral disclosures or fine print may be insufficient to cure a misleading headline or prominent written representation.

- *The representation, omission, or practice must be material*—A representation, omission, or practice is material if it is likely to affect a consumer’s decision regarding a product or service. In general, information about costs, benefits, or restrictions on the use or availability of a product or service is material. When express claims are made with respect to a financial product or service, the claims will be presumed to be material. Similarly, the materiality of an implied claim will be presumed when it is demonstrated

that the institution intended that the consumer draw certain conclusions based upon the claim.

Claims made with the knowledge that they are false will also be presumed to be material. Omissions will be presumed to be material when the financial institution knew or should have known that the consumer needed the omitted information to evaluate the product or service.

## Relationship to Other Laws

Acts or practices that are unfair or deceptive within the meaning of section 5 of the FTC Act may also violate other federal or state statutes. On the other hand, there may be circumstances in which an act or practice violates section 5 of the FTC Act even though the institution is in technical compliance with other applicable laws, such as consumer protection and fair lending laws. Banks should be mindful of both possibilities. The following laws warrant particular attention in this regard.

### Truth in Lending and Truth in Savings Acts

Pursuant to the Truth in Lending Act (TILA), creditors must “clearly and conspicuously” disclose the costs and terms of credit.<sup>9</sup> The Truth in Savings Act (TISA) requires depository institutions to provide interest and fee disclosures for deposit accounts so that consumers can compare deposit products.<sup>10</sup> TISA also provides that advertisements must not be misleading or inaccurate and must not misrepresent an institution’s deposit contract. An act or practice that does not comply with these provisions of TILA or TISA may also violate the FTC Act. On the other hand, a transaction that is in technical compliance with TILA or TISA may nevertheless violate the FTC Act. For example, consumers could be misled by advertisements of “guaranteed” or “lifetime” interest rates when the creditor or depository institution intends to change the rates, whether or not the disclosures satisfy the technical requirements of TILA or TISA.

### Equal Credit Opportunity and Fair Housing Acts

The Equal Credit Opportunity Act (ECOA) prohibits discrimination against persons in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), the fact that an applicant’s income derives from any public assistance program, and the fact

9. 15 USC 1632(a).

10. 12 USC 4301 et seq.

that the applicant has in good faith exercised any right under the Consumer Credit Protection Act. Similarly, the Fair Housing Act (FHA) prohibits creditors involved in residential real estate transactions from discriminating against any person on the basis of race, color, religion, sex, handicap, familial status, or national origin. Unfair or deceptive practices that target or have a disparate impact on consumers who are members of these protected classes may violate the ECOA or the FHA, as well as the FTC Act.

### Fair Debt Collection Practices Act

The Fair Debt Collection Practices Act prohibits unfair, deceptive, and abusive practices related to the collection of consumer debts. Although this statute does not by its terms apply to banks that collect their own debts, failure to adhere to the standards set by this act may support a claim of unfair or deceptive practices in violation of the FTC Act. Moreover, banks that either affirmatively or through lack of oversight permit a third-party debt collector acting on their behalf to engage in deception, harassment, or threats in the collection of monies due may be exposed to liability for approving or assisting in an unfair or deceptive act or practice.

### Managing Risks Related to Unfair or Deceptive Acts or Practices

Since the release of the FDIC's statement and the Board's letter on unfair and deceptive practices in May 2002, bankers have asked for guidance on strategies for managing risk in this area. This section outlines guidance on best practices to address some areas with the greatest potential for unfair or deceptive acts and practices, including advertising and solicitation, servicing and collections, and the management and monitoring of employees and third-party service providers. Banks should also monitor compliance with their own policies in these areas and should have procedures for receiving and addressing consumer complaints and monitoring activities performed by third parties on behalf of the bank.

To avoid engaging in unfair or deceptive activity, the agencies encourage use of the following practices, which have already been adopted by many institutions:

- Review all promotional materials, marketing scripts, and customer agreements and disclosures to ensure that they fairly and adequately describe the terms, benefits, and material limitations of the product or service being offered, including any related or optional products or services, and that they do not mispre-

sent such terms either affirmatively or by omission. Ensure that these materials do not use fine print, separate statements, or inconspicuous disclosures to correct potentially misleading headlines, and ensure that there is a reasonable factual basis for all representations made.

- Draw the attention of customers to key terms, including limitations and conditions, that are important in enabling the customer to make an informed decision regarding whether the product or service meets the customer's needs.
- Clearly disclose all material limitations or conditions on the terms or availability of products or services, such as a limitation that applies a special interest rate only to balance transfers; the expiration date for terms that apply only during an introductory period; material prerequisites for obtaining particular products, services, or terms (for example, minimum transaction amounts, introductory or other fees, or other qualifications); or conditions for canceling a service without charge when the service is offered on a free trial basis.
- Inform consumers in a clear and timely manner about any fees, penalties, or other charges (including charges for any force-placed products) that have been imposed, and the reasons for their imposition.
- Clearly inform customers of contract provisions that permit a change in the terms and conditions of an agreement.
- When using terms such as "preapproved" or "guaranteed," clearly disclose any limitations, conditions, or restrictions on the offer.
- Clearly inform consumers when the account terms approved by the bank for the consumer are less favorable than the advertised terms or terms previously disclosed.
- Tailor advertisements, promotional materials, disclosures, and scripts to take account of the sophistication and experience of the target audience. Do not make claims, representations, or statements that mislead members of the target audience about the cost, value, availability, cost savings, benefits, or terms of the product or service.
- Avoid advertising that a particular service will be provided in connection with an account if the bank does not intend, or is not able, to provide the service to account holders.
- Clearly disclose when optional products and services—such as insurance, travel services, credit protection, and consumer report update services that are offered simultaneously with credit—are not required to obtain credit or considered in decisions to grant credit.

- Ensure that the costs and benefits of optional or related products and services are not misrepresented or presented in an incomplete manner.
- When making claims about amounts of credit available to consumers, accurately and completely represent the amount of potential, approved, or usable credit that the consumer will receive.
- Avoid advertising terms that are not available to most customers and using unrepresentative examples in advertising, marketing, and promotional materials.
- Avoid making representations to consumers that they may pay less than the minimum amount required by the account terms without adequately disclosing any late fees, over-limit fees, or other account fees that will result from the consumer's paying such a reduced amount.
- Clearly disclose a telephone number or mailing address (and, as an addition, an e-mail or web site address if available) that consumers may use to contact the bank or its third-party servicers regarding any complaints they may have, and maintain appropriate procedures for resolving complaints. Consumer complaints should also be reviewed by banks to identify practices that have the potential to be misleading to customers.
- Implement and maintain effective risk and supervisory controls to select and manage third-party servicers.
- Ensure that employees and third parties who market or promote bank products, or service loans, are adequately trained to avoid making statements or taking actions that might be unfair or deceptive.
- Review compensation arrangements for bank employees as well as third-party vendors and

servicers to ensure that they do not create unintended incentives to engage in unfair or deceptive practices.

- Ensure that the institution and its third-party servicers have and follow procedures to credit consumer payments in a timely manner. Consumers should be clearly told when and if monthly payments are applied to fees, penalties, or other charges before being applied to regular principal and interest.

The need for clear and accurate disclosures that are sensitive to the sophistication of the target audience is heightened for products and services that have been associated with abusive practices. Accordingly, banks should take particular care in marketing credit and other products and services to the elderly, the financially vulnerable, and customers who are not financially sophisticated. In addition, creditors should pay particular attention to ensure that disclosures are clear and accurate with respect to the points and other charges that will be financed as part of home-secured loans; the terms and conditions related to insurance offered in connection with loans; loans covered by the Home Ownership and Equity Protection Act; reverse mortgages; credit cards designed to rehabilitate the credit position of the cardholder; and loans with prepayment penalties, temporary introductory terms, or terms that are not available as advertised to all consumers.

## Conclusion

The development and implementation of policies and procedures in these areas and the other steps outlined above will help banks ensure that products and services are provided in a manner that is fair, allows informed customer choice, and is consistent with the FTC Act.



# Branch Closings

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## Background

State member banks are required, by section 42 of the Federal Deposit Insurance Act (FDI Act) (12 USC 1831r-1), to submit a notice of any proposed branch closing to the Federal Reserve at least ninety days before the date of the proposed closing.<sup>1</sup> The notice must include a detailed statement of the reasons for the decision to close the branch and statistical or other information in support of those reasons.

These banks are also required to notify customers of the proposed closing, both by posting a notice at the branch proposed for closure and by mailing a notice of the closure to affected consumers. The notice provided on the branch premises must be posted in a conspicuous manner at least thirty days before the proposed closing. The mailed notice must be provided to branch customers at least ninety days before the proposed closing.

An interstate bank regulated by the Federal Reserve that proposes to close a branch located in a low- or moderate-income area is required to include in its notice to customers the mailing address of its Reserve Bank supervisor and a statement that comments on the closing may be mailed to the Reserve Bank.<sup>2</sup> In those cases, a person from the affected area may submit a written request to the Reserve Bank relating to the proposed closing, stating specific reasons for the request and including a discussion of the adverse effect the closing may have on the availability of banking services in the affected area. If the Reserve Bank, in conjunction with the Board, determines that the request is not frivolous, it must

convene a meeting of appropriate individuals, organizations, depository institutions, and Federal Reserve and other regulatory agency representatives, as determined by the Federal Reserve at its discretion, to explore the feasibility of obtaining adequate alternative facilities and services for the affected area following the closing of the branch.

Finally, each institution must adopt policies regarding closings of branches of the institution.

## Applicability

The bank closure provisions apply to traditional brick-and-mortar branches or similar banking facilities at which deposits are received, checks are paid, or money is lent.<sup>3</sup> Notice is not required for the closing of a nonbranch facility, such as an ATM, a remote service facility, a loan-production office, or a temporary branch.<sup>4</sup> Nor does section 42 apply to mergers, consolidations, or other acquisitions, including branch sales, that do not result in any branch closings.

## Mergers

An institution must file a branch closing notice whenever it closes a branch, including when the closing occurs in the context of a merger, consolidation, or other form of acquisition.<sup>5</sup> Branch closings that occur in the context of transactions subject to the Bank Merger Act (12 USC 1828) require a branch closing notice, even if the transaction received expedited treatment under that act. The responsibility for filing the notice lies with the acquiring or resulting institution, but either party to such a transaction may give the notice. Thus, for example, the purchaser may give the notice prior to consummation of the transaction when the purchaser intends to close a branch following consummation, or the seller may give the notice because it intends to close a branch at or prior to consummation. In the latter example, if the transaction were to close ahead of schedule, the purchaser, if authorized by the Federal Reserve,

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1. Section 42, which was added to the Federal Deposit Insurance Act by section 228 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102-242, 105 Stat. 2236), became effective in December 1991. Section 42 was amended by section 106 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 and by the Economic Growth and Regulatory Paperwork Reduction Act of 1996. This chapter is adapted from the Joint Policy Statement regarding Branch Closings issued by the Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, effective June 29, 1999. The statement is available at [www.federalreserve.gov/boarddocs/press/boardacts/1999/19990707/r-1036.pdf](http://www.federalreserve.gov/boarddocs/press/boardacts/1999/19990707/r-1036.pdf).

2. An *interstate bank* is a bank that maintains branches in more than one state. A *low- or moderate-income area* is a census tract for which the median family income is (1) less than 80 percent of the median family income for the metropolitan statistical area (as designated by the director of the Office of Management and Budget) in which the census tract is located or (2) in the case of a census tract that is not located in a metropolitan statistical area, less than 80 percent of the median family income for the state in which the census tract is located, as determined without taking into account family income in metropolitan statistical areas in the state (12 USC 1831r(d)(4)).

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3. Insured branches of foreign banks are not considered "branches" for purposes of section 42 because they are subject to separate liquidation procedures as specified in 12 CFR 28.22 (federal branches of foreign banks) and 12 CFR 211.25(f) (state branches of foreign banks).

4. The 1996 amendment expressly stated that section 42 does not apply with respect to automated teller machines (Pub. L. 104208, 110 Stat. 3009).

5. See the section "Other Applicability Considerations" for information on certain branches closed in connection with emergency acquisitions or FDIC assistance or a branch subsequently transferred back to the FDIC pursuant to an acquisition agreement.

could operate the branch to complete compliance with the ninety-day requirement and would not need to give an additional notice.

## Relocations and Consolidations

Section 42 does not apply when a branch is relocated or is consolidated with one or more other branches, provided that the relocation or consolidation occurs within the immediate neighborhood and does not substantially affect the nature of the business or customers served.

A *branch relocation* is a movement within the same immediate neighborhood that does not substantially affect the nature of the business or customers served. Generally, relocations will be found to have occurred only when short distances are involved—for example, across the street, around the corner, or a block or two away. Moves of less than 1,000 feet will generally be considered relocations. In less densely populated areas, where neighborhoods extend farther and a long move would not significantly affect the nature of the business or the customers served by the branch, a relocation may occur over substantially longer distances.

Generally, consolidations of branches are considered relocations if the branches are located within the same neighborhood and the nature of the business or customers served is not affected. Thus, for example, a consolidation of two branches on the same block following a merger would not constitute a branch closing. The same guidelines apply to consolidations as to relocations.

## Other Applicability Considerations

A change in the services offered at a branch is not considered a branch closing, provided that the remaining facility constitutes a branch (as defined herein).<sup>6</sup>

Section 42 also does not apply when a branch ceases operation but is not closed by an institution. Thus, it does not apply to

- A temporary interruption of service caused by an event beyond the institution's control (for example, a natural catastrophe), if the insured depository institution plans to restore branching services at the site in a timely manner<sup>7</sup>

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6. If after a reduction in services the resulting facility no longer qualifies as a branch, section 42 would apply. Thus, notices of branch closing would be required if an institution were to replace a traditional brick-and-mortar branch with an ATM.

7. Section 42 would apply, however, if the institution did not reopen the branch following the incident. Although prior notice would not be possible in such a case, the institution should notify the customers of the branch and the Federal Reserve in the manner specified by section 42 to the extent possible and as soon as possible after the decision to close the branch has been made.

- The transferal back to the FDIC, pursuant to the terms of an acquisition agreement, of a branch of a failed bank operated on an interim basis in connection with the acquisition of all or part of a failed bank, as long as the transfer occurs within the option period or within an occupancy period, not to exceed 180 days, specified in the agreement
- A branch that is closed in connection with an emergency acquisition under section 11(n), 13(f), or 13(k) of the FDI Act or with any assistance provided by the FDIC under section 13(c) of the FDI Act (12 USC 182(n), 1823(f) and (k), and 1823(c))

## Notice of Branch Closing to the Federal Reserve

A state member bank's notice of a proposed branch closing to the Federal Reserve must include the following:

- The identity of the branch to be closed
- The proposed date of closing
- A detailed statement of the reasons for the decision to close the branch
- Statistical or other information in support of those reasons consistent with the institution's written policy for branch closings

If an institution believes that certain information included in the notice is confidential in nature, it should prepare that information separately and request confidential treatment. The Federal Reserve will decide whether to treat the information confidentially under the Freedom of Information Act (5 USC 552).

If a notice provided to a state supervisory agency pursuant to state law contains the information outlined above, the institution may provide a copy of that notice to the Federal Reserve, provided that the notice is filed at least ninety days prior to the date of the branch closing.

## Notice of Branch Closing to Customers

### Customer Allocation

For purposes of providing notice of the proposed closing to the customers of the branch, a *customer of a branch* is a patron of a state member depository institution who has been identified with a particular branch by the institution through use, in good faith, of a reasonable method of allocating customers to specific branches. An institution that allocates customers on the basis of where a customer opened his or her deposit or loan

account is presumed to have reasonably identified each customer of a branch. Although the use of this means of allocation, and perhaps others, may result in certain facilities that technically constitute branches being assigned no customers, this result is permissible so long as the means of allocation is reasonable; if such a branch is closed, notification to the Federal Reserve and posting of a notice on the branch premises will suffice. Finally, a state member institution need not change its recordkeeping system in order to make a reasonable determination of who is a customer of a branch.

An institution must include a customer notice at least ninety days in advance of the proposed closing in at least one of the regular account statements mailed to customers, or in a separate mailing. If the branch closing occurs after the proposed date of closing, an additional notice need not be mailed to customers (or provided to the Federal Reserve) if the institution acted in good faith in projecting the date for closing and in subsequently delaying the closing.

## Content

The mailed customer notice should state the location of the branch to be closed and the proposed date of closing and should either identify another location at which customers can obtain service after the closing or provide a telephone number that customers can call to learn about alternative sites. If a notice of branch closing provided to customers pursuant to state law contains this information, a separate notice need not be sent, provided that the notice is sent at least ninety days prior to the closing.

## Low- and Moderate-Income Areas Served by Interstate Banks

If the state member bank maintains branches in more than one state and the branch to be closed is located in a low- or moderate-income area, the mailed customer notice must contain the mailing address of the appropriate Reserve Bank and a statement that comments on the proposed branch closing may be mailed to that entity. The notice should also state that the Federal Reserve does not have the authority to approve or prevent the branch closing.

Additional rules apply if the System receives a written request concerning the proposed closing from a person within a low- or moderate-income area served by the branch. In this case, if the request states specific reasons for the request, including a discussion of the adverse effect of the closing on the availability of banking services in the

affected area, and if the Federal Reserve concludes that the request is not frivolous, the Federal Reserve must convene a meeting of Federal Reserve representatives, other interested depository institution regulatory agencies, community leaders, and other appropriate individuals, organizations, and depository institutions, as determined by the Federal Reserve at its discretion. The purpose of the meeting shall be to explore the feasibility of obtaining adequate alternate facilities and services for the affected area, including the establishment of a new branch by another depository institution, the chartering of a new depository institution, or the establishment of a community development credit union, following the closing of the branch.

In the case of an institution that will become an interstate bank prior to the closure of a branch in a low- or moderate-income area, such information must be included in the notice unless the closure will occur immediately upon consummation of the transaction that causes the institution to become interstate.

No action by the Federal Reserve under this provision shall affect the authority of an interstate bank to close a branch (including the timing of the closing) if the requirements of section 42(a) and (b) of the FDI Act (regarding notice to the appropriate federal banking agency and notice to the institution's customers) have been met by such bank with respect to the branch being closed.

## On-Site Notice

The on-site notice to branch customers should be posted in a conspicuous manner on the branch premises at least thirty days prior to the proposed closing. The notice should state the proposed date of closing and should identify another location where customers can obtain service after that date or provide a telephone number that customers can call to learn about alternative sites. An institution may revise the notice to extend the projected closing date without triggering a new thirty-day notice period.

## Contingent Notices

In some situations, an institution, at its discretion and to expedite transactions, may mail and post notices to customers of a proposed branch closing that is contingent upon an event. For example, in the case of a proposed merger or acquisition, an institution may notify customers of its intent to close a branch upon the Federal Reserve Board's approval of the proposed merger or acquisition.

## Policies for Branch Closings

The law requires all insured depository institutions to adopt policies for branch closings. Each institution with one or more branches must adopt such a policy. If an institution currently has no branches, it must adopt a policy for branch closing before it establishes its first branch. The policy should be in writing, should be appropriate for the size of the institution, and should meet the needs of the institution.

The branch closing policy should include criteria for determining which branch is to be closed and which customers should be notified as well as procedures for providing the required notices.

## Compliance

Compliance with the requirements to adopt a branch closing policy and provide the notices when a branch is to be closed is determined during routine compliance examinations. Failure to comply may result in adverse findings in the compliance evaluation or in an enforcement action.

## Examination Tips

### Workpapers

Federal Reserve System examiners review the technical aspects of section 42 during routine compliance examinations and evaluate the effect of any branch closures on low- and moderate-income communities during CRA examinations. Because

branch closure issues may be raised in bank holding company or other CRA-related applications outside the examination process, examiners should ensure that their workpapers adequately support conclusions about a bank's branch closure policy and any specific branch closures reviewed. For example, in addition to answering the questions in the examination checklist, examiners should note whether the bank has an adequate written branch closing policy in place, whether this policy was followed for any branch closings, and whether the bank adequately documented the reasons for the closure. Documentation related to the branch closure, including the dates the notice was mailed to the appropriate parties and posted on the branch premises, specific reasons for the closure, and other data used by the bank to support its decision to close the branch (such as statistical data concerning branch profitability or loss), should be included in the workpapers.

## Meetings

Regulators have no authority to tell a bank that it may not close a branch. Meetings convened to discuss state member bank branch closures in low- and moderate-income areas pursuant to section 42 are generally not considered public meetings. Instead, these are more on the order of private meetings to discuss alternatives to providing banking services to the affected community. As a result, attendance at these meetings should be limited to parties invited by the Federal Reserve and may be held after the branch is closed.

# Branch Closings

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

1. To determine whether the institution is in compliance with the statutory requirements for branch closings, including those relating to the following:
  - a. Providing prior notification of any branch closing to its appropriate federal banking agency and to customers of the branch
  - b. Establishing internal policies for branch closings

### EXAMINATION PROCEDURES

1. Determine whether the institution has any branches that would subject it to the Joint Policy Statement regarding Branch Closings and section 42 of the Federal Deposit Insurance Act.
2. Determine whether the institution has adopted a branch closing policy that ensures compliance with the policy statement regarding branch closings and section 42 of the FDI Act.
3. Determine whether the institution's procedures for closing a branch have been followed since the last examination in which compliance with the policy statement for branch closing notices and section 42 of the FDI Act was assessed.
4. For any branch closed since the last examination, determine whether the institution provided adequate notice of any branch closing to the Federal Reserve at least 90 days prior to the proposed closing.
5. For any branch closed since the last examination, determine if the institution mailed an adequate notice to its customers at least 90 days prior to the proposed closing.
6. For any branch closed since the last examination, determine if the institution posted a notice to the branch customers in a conspicuous manner on the branch premises at least 30 days prior to the proposed closing.



# Branch Closings Examination Checklist

1. Does the insured depository institution have any branches, as defined in the Joint Policy Statement regarding Branch Closings, that would make it subject to the policy statement and to section 42 of the Federal Deposit Insurance Act?	Yes	No
or		
Since the last exam, has the insured depository institution closed any of its branches, making it subject to the notification requirements of the policy statement and section 42 of the FDI Act?	Yes	No
Note: If the answer to both questions is "no," do not proceed with this checklist.		
2. Has the institution provided written notice of any branch closing to the Federal Reserve at least 90 days in advance of the closing? (§ 42(a)(1))	Yes	No
3. Did the notice to the Federal Reserve contain		
a. The identity of the branch to be closed (§ 42(a)(1))	Yes	No
b. The proposed closing date (§ 42(a)(1))	Yes	No
c. The specific reasons for the closure (§ 42(a)(2)(A))	Yes	No
d. Statistical or other information in support of the reason(s) and consistent with the institution's written policy for branch closings (§ 42(a)(2)(B))	Yes	No
4. Did the institution provide to customers written notice of the branch closure, in a regular account statement or separate mailing, at least 90 days before the closing? (§ 42(b)(2)(B))	Yes	No
5. Did the mailed customer notice contain		
a. The location of the branch to be closed (§ 42(b)(1))	Yes	No
b. The proposed closing date (§ 42(b)(2)(B))	Yes	No
c. A list of alternative banking locations or a phone number to call to obtain information about possible alternatives (§ 42(b)(1))	Yes	No
6. Did the institution conspicuously display a notice to customers on the premises of the branch to be closed at least 30 days before the closing? (§ 42(b)(2)(A))	Yes	No
7. Did the notice that was posted on the bank premises contain		
a. The proposed closing date (§ 42(b)(2)(A))	Yes	No
b. A list of alternative banking locations or a phone number to call to obtain information about possible alternatives (§ 42(b)(1))	Yes	No
8. Has the institution adopted a written branch closing policy? (§ 42(c))	Yes	No
9. Does the written branch closing policy include (§ 42(c))		
a. Factors for determining which branch to close	Yes	No
b. Factors for determining which customers to notify	Yes	No
c. Procedures for providing the required notices	Yes	No
10. Pursuant to state law, did the institution provide notifications consistent with the requirements of section 42 to the customers of the branch to be closed? (See checklist items 5 and 7.) (Note: If the answer is "yes," a second notice need not be sent in order to comply with the policy statement.)	Yes	No

11. If, pursuant to state law, the institution provided its state supervisor with a notice of a branch closing,
- a. Did the institution also provide a copy of that notice to the Federal Reserve? (§ 42(a)(1)) Yes      No
  - b. Did the notice contain information consistent with the notice required by section 42? (See checklist item 3.) Yes      No
  - c. Was the notice filed with the Federal Reserve at least 90 days before the date of the proposed branch closing? (§ 42(a)(1)) Yes      No



# Children's Online Privacy Protection Act

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## Background

Financial institutions that operate one or more web sites or online services directed at children (or a portion of such a web site or service), or that have knowledge that they are collecting or maintaining personal information from a child online, are subject to certain regulatory requirements. Those requirements, which are set forth in the Children's Online Privacy Protection Act of 1998 (COPPA) (15 USC 6501 et seq.), address the collection, use, and disclosure of personal information about children collected from children through web sites or other online services. The regulation that implements COPPA (16 CFR 312) was issued in November 1999 by the Federal Trade Commission and became effective in April 2000. Each of the federal financial regulatory agencies has enforcement authority for COPPA over the institutions it supervises.

## Definitions

- *Child (children)*—An individual (individuals) under the age of 13
- *Operator*—Any person who operates a web site located on the Internet or an online service and who collects or maintains personal information from or about the users of, or visitors to, such a web site, or on whose behalf such information is collected or maintained where the web site or online service is used for commercial purposes
- *Personal information*—Individually identifiable information about an individual collected online, including first and last names, home address, e-mail address, telephone number, Social Security number, or any combination of information that permits physical or online contact

## General Requirements

Operators of web sites or online services directed at children, and operators who have knowledge that they are collecting or maintaining personal information from children, are required to

- Provide, on the web site or online service, a clear, complete, and understandable written notice of information-collection practices with regard to children, describing how the operator collects, uses, and discloses the information (§ 312.4)
- Obtain, through reasonable efforts and with limited exceptions, verifiable parental consent

before collecting, using, or disclosing personal information from children (§ 312.5)

- Provide a parent, upon request, with the means of reviewing the personal information collected from his or her child and of refusing to permit the information's further use or maintenance (§ 312.6)
- Limit collection of personal information for the purpose of facilitating a child's online participation in a game, prize offer, or other activity to that information that is reasonably necessary for the activity (§ 312.7)
- Establish and maintain reasonable procedures to protect the confidentiality, security, and integrity of the personal information collected from children (§ 312.8)

## Notice on Web Site

### Placement of Notice

An operator of a web site or online service directed at children must post, on its home page and everywhere on the site or service where it collects personal information from any child, a link taking viewers to a notice of its information practices with regard to children. An operator of a general-audience web site that has a separate children's area must post a link to its notice on the home page of the children's area.

Such links must be placed in a clear and prominent place on the home page of the web site or online service. To make the link clear and prominent, an operator may, for example, use a larger font size in a different color on a contrasting background. A link in small print at the bottom of a home page or a link that is indistinguishable from adjacent links does not satisfy the "clear and prominent" guidelines.

### Content of Notice

The web site notice must, among other requirements, state

- The name, address, telephone number, and e-mail address of all operators collecting or maintaining personal information from children through the web site or online service; or the same information for one operator who will respond to all inquiries, in addition to the names of all the operators
- The types of personal information collected from children, and how the information is collected

- How the operator uses or may use the personal information
- Whether the operator discloses information collected to third parties. If it does, the notice must state
  - The types of business engaged in by the third parties
  - The purposes for which the information is used
  - Whether the third parties have agreed to maintain the confidentiality, security, and integrity of the information
  - That the parent has the option of consenting to the collection and use of the information without consenting to the disclosure of the information to third parties
- That the operator may not require, as a condition of participation in an activity, that a child disclose more information than is reasonably necessary to participate in the activity
- That a parent may review his or her child's personal information, have it deleted, and refuse to allow any further collection or use of the child's information. Procedures for parental review, deletion, and refusal to allow further collection or use must also be included in the notice.

## Notice to Parent

### Content of Notice

An operator is required to obtain verifiable parental consent before collecting, using, or disclosing personal information from children. An operator must also make reasonable efforts to provide a parent with notice of the operator's information practices with regard to children, as described above, and, in the case of a notice seeking consent, must state the following:

- That the operator wishes to collect personal information from the parent's child
- That the parent's consent is required for the collection, use, and disclosure of the information
- How the parent can provide consent

### Parental Consent and Review of Information

#### *Methods of Obtaining Parental Consent*

Obtaining verifiable parental consent may be done by any of several methods. Currently, operators may take a "sliding-scale" approach whereby the method of obtaining parental consent depends on how the financial institution intends to use the child's personal information.

Under the sliding-scale approach, if the information is to be used solely for internal purposes

(including use by an operating subsidiary or an affiliate), the required method of obtaining consent is less rigorous. A financial institution that uses the information internally may obtain parental consent via e-mail, provided that the operator takes additional steps to verify that the person providing consent is in fact the child's parent by, for example, confirming receipt of consent by e-mail, letter, or telephone call. Operators who use such methods must provide notice that the parent may revoke consent.

The sliding-scale approach was adopted in anticipation that technical developments would eventually allow the use of more-reliable methods to verify identities. This approach, which was originally scheduled to be phased out by April 15, 2005, has been extended indefinitely by the FTC.

If, in contrast, the information is to be disclosed to others (for example, to chat rooms, message boards, or third parties), putting the child's privacy at greater risk, a more-reliable method of consent is required. These more-reliable methods include

- Obtaining a signed consent form from a parent via mail or fax
- Accepting and verifying a credit card number
- Taking a call from a parent, through a toll-free telephone number staffed by trained personnel
- Receiving e-mail accompanied by a digital signature
- Receiving e-mail accompanied by a PIN or password obtained through one of the verification methods described in the bullet items above

#### *Parent-Permitted Disclosures to Third Parties*

A parent may permit an operator of a web site or online service to collect and use information about a child while prohibiting the operator from disclosing the child's information to third parties. An operator must give a parent this option.

#### *Parental Consent to Material Changes*

An operator must send a new notice and request for consent to a parent if there is a material change in the collection, use, or disclosure practices to which the parent has previously agreed.

#### *Exceptions to Prior-Parental-Consent Requirement*

A financial institution does not need prior parental consent to collect

- A parent's or child's name or online contact information solely to obtain consent or to provide notice. If the operator has not obtained parental

consent in a reasonable time after the information was collected, the operator must delete the information from its records

- A child's online contact information solely to respond on a one-time basis to a specific request from the child. In such an instance, the contact information must not be used to re-contact the child and must be deleted.
- A child's online contact information to respond more than once to a specific request made by the child (for example, a request to receive a monthly online newsletter), if the parent is notified and allowed to request that the information not be used in any other way
- The name and online contact information of the child to be used solely to protect the child's safety
- The name and online contact information of the child solely to protect the security of the site, to take precautions against liability, or to respond to judicial process, law enforcement agencies, or an investigation related to public safety

#### *Parental Right to Review Information*

An operator of a web site or online service is required to provide a parent with a means of obtaining any personal information collected from his or her child. At a parent's request, the operator must provide the parent with a description of the types of personal information it has collected from the child and an opportunity to review the information collected from the child.

Before a parent is permitted to review a child's information, the operator must take steps to ensure that the person making the request is the child's parent. An operator or its agent will not be held liable under any federal or state laws for any disclosures made in good faith and after having followed reasonable procedures to verify the requester's identity.

Parents may refuse to permit an operator to continue to use or collect a child's personal information in the future and may instruct the operator to delete the information. If a parent does so, the operator may terminate its service to that child.

## Other Requirements

### Confidentiality, Security, and Integrity of Personal Information Collected from a Child

The operator of a web site or an online service is required to establish and maintain reasonable procedures to protect the confidentiality, security, and integrity of personal information collected from a child. Operators must have adequate policies and procedures for protecting a child's personal information from loss, misuse, unauthorized access, or disclosure. Operators are permitted to select an appropriate method for implementing this provision.

### Safe Harbor

With prior FTC approval, industry groups, financial institutions, and others may establish a self-regulatory program. Web site operators and online services that comply with FTC-approved self-regulatory guidelines will receive a "safe harbor" from the requirements of COPPA and the regulation. Self-regulatory guidelines must require the implementation of substantially similar requirements that provide the same or greater protections for a child as sections 312.2 through 312.9 of the regulation. The guidelines must also include an effective, mandatory mechanism for assessing operators' compliance as well as incentives to ensure that an operator will comply.



# Children's Online Privacy Protection Act Examination Objectives and Procedures

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## EXAMINATION OBJECTIVES

1. To assess the quality of a financial institution's compliance management policies and procedures for implementing COPPA, specifically, for ensuring consistency between an institution's notices about policies and practices and what it actually does
2. To determine the degree of reliance that can be placed on a financial institution's internal controls and procedures for monitoring compliance with COPPA
3. To determine a financial institution's compliance with COPPA, specifically, in meeting the following requirements:
  - Providing, on the web site or online service, a clear, complete, and understandable written notice of its information-collection practices with regard to children that describes how the operator collects, uses, and discloses the information
  - Obtaining, through reasonable efforts and with limited exceptions, verifiable parental consent prior to the collection, use, or disclosure of personal information from children
  - Providing a parent, upon request, with the means of reviewing the personal information collected from his or her child and the means with which to refuse its further use or maintenance
  - Complying with any direction or request of a parent concerning his or her child's information
  - Limiting collection of personal information for a child's online participation in a game, prize offer, or other activity to information that is reasonably necessary for the activity
  - Establishing and maintaining reasonable procedures to protect the confidentiality, security, and integrity of the personal information collected from children
4. To initiate effective corrective actions when violations of law are identified or when policies or internal controls are deficient

## EXAMINATION PROCEDURES

### Initial Procedures

1. From direct observation of the financial institution's web site or online service and through discussions with appropriate management officials, ascertain whether the institution is subject to COPPA by determining if it operates a web site or online service that

- Is directed at children
- Knowingly collects or maintains personal information from children

Note: Stop here if the institution does not currently operate a web site that is directed to children or does not knowingly collect information about children. In these cases the institution is not subject to COPPA, and no further examination for COPPA is necessary.

2. Determine if the financial institution is participating in an FTC-approved self-regulatory program.
  - If it is, obtain a copy of the program and supporting documentation, such as reviews or audits, that demonstrate the financial institution's compliance with the program. If the self-regulatory authority (SRA) determined that the financial institution was in compliance with COPPA at the most recent review or audit or has not yet made a determination, no further examination for COPPA is necessary. If, on the other hand, the SRA determined that the institution was not in compliance with COPPA and the institution has not taken appropriate corrective action, continue with the remaining procedures.
  - If the financial institution is not participating in a FTC-approved self-regulatory program, continue with the remaining procedures.
3. Determine, through a review of available information, whether the financial institution's internal controls are adequate to ensure compliance with COPPA. Consider the following:
  - Organization chart, to determine who is responsible for the financial institution's compliance with COPPA

- Process flowcharts, to determine how the institution's COPPA compliance is planned for, evaluated, and achieved
  - Policies and procedures that relate to COPPA compliance
  - Methods of collecting or maintaining personal information from the web site or online service
  - List of data elements collected from any children and a description of how the data are used and protected
  - List of data elements collected from any children that are disclosed to third parties, and any contracts or agreements with those third parties governing the use of that information
  - Complaints regarding the treatment of data collected from a child
  - Internal checklists, worksheets, and other review documents
4. Review applicable audit and compliance review material, including workpapers, checklists, and reports, to determine whether
    - The procedures address the COPPA provisions applicable to the institution
    - Effective corrective action occurred in response to previously identified deficiencies
    - The audits and reviews performed were reasonable and accurate
    - Deficiencies, their causes, and the effective corrective actions are consistently reported to management or members of the board of directors
    - The frequency of the compliance review is satisfactory
  5. Review, as available, a sample of complaints that allege the inappropriate collection, sharing, or use of data from a child to determine whether there are any areas of concern.
  6. Based on the results of the foregoing, determine the depth of the examination review, focusing on the areas of particular risk. The procedures to be employed depend on the adequacy of the institution's compliance management system and the level of risk identified.
- including data shared with third parties, if applicable, and determine whether
- The institution has established and maintained reasonable procedures to protect the confidentiality, security, and integrity of personal information collected from a child (§§ 312.3 and 312.8)
  - Data are collected, used, and shared in accordance with the institution's web site notice (§§ 312.3 and 312.4)
  - Parental permission was obtained prior to the use, collection, or sharing of information, including consent to any material change in such practices (§ 312.5(a))
  - Data are collected, used, and shared in accordance with parental consent (§§ 312.5 and 312.6)
3. Through testing or management's demonstration of the web site or online service and a review of a sample of parental consent forms or other documentation, determine whether the institution has a reasonable method for verifying that the person providing the consent is the child's parent. (§ 312.5(b)(2))
  4. Review a sample of parental requests for personal information provided by their children, and verify that the institution
    - Provided, upon request, a description of the specific types of personal information collected (§ 312.6(a)(1))
    - Complied with a parent's instructions concerning the collection, use, maintenance, or disclosure of his or her child's information (§ 312.6(a)(2))
    - Allowed a parent to review any personal information collected from the child (§ 312.6(a)(3))
    - Verified that the person requesting information is a parent of the child (§ 312.6(a)(3))
  5. Through testing or management's demonstration of the web site or online service, verify that the institution does not condition a child's participation in a game, offering of a prize, or another activity on the child's disclosure of more personal information than is reasonably necessary to participate in the activity. (§ 312.7)

## Verification Procedures

1. Review the notice describing the financial institution's information practices with regard to children to determine whether it is clearly and prominently placed on the web site and contains all information required by the regulation. (§ 312.4)
2. Obtain a sample of data collected from children,

## Conclusions

1. Summarize all findings, supervisory concerns, and regulatory violations.
2. Determine the root cause of any violations by identifying weaknesses in internal controls, audit and compliance reviews, training, manage-

- ment oversight, or other factors; also, determine whether the violations are repetitive or systemic.
3. Identify any action needed to correct violations and weaknesses in the financial institution's compliance system.
  4. Discuss findings with the institution's management and obtain a commitment for corrective action.





# Children's Online Privacy Protection Act Worksheet

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## Notice on Web Site

- |  |     |    |
|--|-----|----|
| 1. Does the financial institution knowingly collect or maintain personal information from a child in a manner that violates the regulation? (§ 312.3)  | Yes | No |
| 2. Is the link to the notice clearly labeled as a notice of the web site's information practices with regard to children, and is it placed in a clear and prominent place on the home page of the web site and at each area on the web site where a child directly provides or is asked to provide personal information? (§ 312.4(b)(1)) | Yes | No |
| 3. Does the notice state   |     |    |
| • The name, address, telephone number, and e-mail address of all operators collecting or maintaining personal information from any children through the web site or online service, or the same information for one operator who will respond to all inquiries along with the names of all operators (§ 312.4(b)(2)(i))                  | Yes | No |
| • The types of information collected from a child, and whether the information is collected directly or passively (§ 312.4(b)(2)(ii))  | Yes | No |
| • How such information is or may be used (§ 312.4(b)(2)(iii))  | Yes | No |
| • Whether such information is disclosed to third parties. If it is, determine whether the notice states  |     |    |
| – The types of businesses engaged in by the third parties  | Yes | No |
| – The purposes for which the information is used   | Yes | No |
| – That the third parties have agreed to maintain the confidentiality, security, and integrity of the information   | Yes | No |
| – That a parent has the option to consent to the collection and use of the information without consenting to the disclosure of the information to third parties (§ 312.4(b)(2)(iv))  | Yes | No |
| • That the operator is prohibited from conditioning a child's participation in an activity on the disclosure of more information than is reasonably necessary to participate in such activity (§ 312.4(b)(2)(v))   | Yes | No |
| • That a parent may review and have deleted the child's personal information, may refuse to permit further collection or use of the child's information, and is provided with the procedures for doing so (§ 312.4(b)(2)(vi))  | Yes | No |

## Notice to a Parent

- |  |     |    |
|--|-----|----|
| 4. Does the financial institution make reasonable efforts to ensure that a parent of the child receives the notice? (§ 312.4(c))   | Yes | No |
| 5. Does the notice to the parent state   |     |    |
| • That the operator wishes to collect information from the child (§ 312.4(c)(1)(i)(A))   | Yes | No |
| • The institution's practices regarding children, as noted on its web site (§§ 312.4(b)(2) and 312.4(c)(1)(i)(B))  | Yes | No |
| • That the parent's consent is required for the collection, use, and disclosure of such information, and the means by which the parent can provide verifiable consent to the collection of information (§ 312.4(c)(1)(ii)) | Yes | No |

- If the operator has collected information from a child that will be used to respond directly more than once to a specific request from the child, does the notice state
  - That the operator has collected the child's online contact information to respond to the child's request for information, and that the requested information will require more than one contact with the child Yes    No
  - That the parent may refuse to permit further contact with the child and require the deletion of the information, and how the parent can do so Yes    No
  - That if the parent fails to respond to the notice, the operator may use the information for the purpose(s) stated in the notice (§ 312.4(c)(1)(iii)) Yes    No
- If the purpose behind the collection of information is to protect the safety of the child, does the notice state
  - That the operator has collected the child's name and online contact information to protect the safety of the child Yes    No
  - That the parent may refuse to permit further contact with the child and require the deletion of the information, and how the parent can do so Yes    No
  - If the parent fails to respond to the notice, that the operator may use the information for the purpose(s) stated in the notice (§ 312.4(c)(1)(iv)) Yes    No

### Parental Consent

6. Does the financial institution obtain the consent of the parent prior to any collection, use, or disclosure of personal information from any children, outside the exceptions listed in section 312.5(c)? (§ 312.5(a)(1)) Yes    No
7. If changes to the policy on collecting, using, or disclosing data on children occurred, does the institution request and review updated consent forms or documentation and determine whether parental permission is still in effect? (§ 312.5(a)) Yes    No
8. Does the institution have a reasonable method for verifying that the person providing the consent is the child's parent? (§ 312.5(b)(2)) Yes    No

### Right of Parent to Review Personal Information Provided by a Child

9. Does the financial institution respond to parental requests to review information provided by their children by providing
  - A description of the specific types of personal information collected (§ 312.6(a)(1)) Yes    No
  - The opportunity for the parent to refuse to permit the further use or collection of personal information and to direct the financial institution to delete the child's personal information (§ 312.6(a)(2)) Yes    No
  - Procedures for reviewing any personal information collected from the child (§ 312.6(a)(3)) Yes    No
  - Adequate procedures to ensure that those persons requesting information are parents of the child in question (§ 312.6(a)(3)) Yes    No

### Prohibition against Conditioning a Child's Participation on Collection of Personal Information

10. Does the operator refrain from conditioning a child's participation in a game, the offering of a prize, or another activity on the child's disclosure of more personal information than necessary to participate? (§ 312.7) Yes    No

### Confidentiality, Security, and Integrity of Personal Information Collected from a Child

11. Does the financial institution maintain reasonable policies and procedures for protecting a child's personal information from loss, misuse, unauthorized access, or disclosure? (§ 312.8)

Yes      No



# Right to Financial Privacy Act

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## Background

The Right to Financial Privacy Act of 1978 was enacted to provide the financial records of financial institution customers a reasonable amount of privacy from federal government scrutiny. The act, which became effective in March 1979, establishes specific procedures that government authorities must follow when requesting a customer's financial records from a bank or other financial institution. It also imposes duties and limitations on financial institutions prior to the release of information sought by government agencies. In addition, the act generally requires that customers receive

- A written notice of the federal authority's intent to obtain financial records
- An explanation of the purpose for which the records are sought
- A statement describing procedures to follow if the customer does not wish such records or information to be made available

Certain exceptions allow for delayed notice or no customer notice at all.

Prior to passage of the act, bank customers were not informed that their personal financial records were being turned over to a government authority and could not challenge government access to the records. In *United States v. Miller* (425 U.S. 435 (1976)), the Supreme Court held that because financial records are maintained by a financial institution, the records belong to the institution rather than the customer; therefore, the customer has no protectable legal interest in the bank's records and cannot limit government access to those records. It was principally in response to this decision that the Right to Financial Privacy Act was enacted.

## Coverage

Coverage under the act specifically extends to customers of financial institutions. A *customer* is defined as any person or authorized representative of that person who uses or has used any service of a financial institution. The definition also includes any person for whom the financial institution acts as a fiduciary. Corporations and partnerships of six or more individuals are not considered customers for purposes of the act.

## Requirements

To obtain access to, copies of, or information contained in a customer's financial records, a government authority, generally, must first obtain one of the following:

- An authorization, signed and dated by the customer, that identifies the records, the reasons the records are being requested, and the customer's rights under the act
- An administrative subpoena or summons
- A search warrant
- A judicial subpoena
- A formal written request by a government agency (to be used only if no administrative summons or subpoena authority is available)

A financial institution may not release a customer's financial records until the government authority seeking the records certifies in writing that it has complied with the applicable provision of the act. In addition, the institution must maintain a record of all instances in which a customer's records are disclosed to a government authority pursuant to customer authorization. The records should include the date, the name of the government authority, and an identification of the records disclosed. Generally, the customer has a right to inspect the records.

Although there are no specific record-retention requirements in the act, financial institutions should retain copies of all administrative and judicial subpoenas, search warrants, and formal written requests given to them by federal government agencies or departments along with the written certification required.

A financial institution must begin assembling the required information upon receipt of the agency's summons or subpoena or a judicial subpoena and must be prepared to deliver the records upon receipt of the written certificate of compliance.

## Cost Reimbursement

With certain exceptions, government entities must reimburse financial institutions for the cost of providing the information. This reimbursement may include costs for assembling or providing records, reproduction and transportation costs, or any other costs reasonably necessary or incurred in gathering and delivering the requested information. The Board's Regulation S establishes rates and the conditions under which these payments may be made.

## Exceptions to Notice and Certification Requirements

In general, exceptions to the notice and certification requirements cover situations pertinent to routine banking business, information requested by supervisory agencies, and requests subject to other statutory requirements. Specific exceptions include records

- Submitted by financial institutions to any court or agency when perfecting a security interest, proving a claim in bankruptcy, or collecting a debt for itself or a fiduciary
- Requested by a supervisory agency in connection with its supervisory, regulatory, or monetary functions (including regular examinations and any investigations relating to consumer complaints)
- Sought in accordance with procedures authorized by the Internal Revenue Code (records that are intended to be accessed by procedures authorized by the Tax Reform Act of 1976)
- Required to be reported in accordance with any federal statute (or rule promulgated thereunder, such as the Bank Secrecy Act)
- Requested by the Government Accountability Office for an authorized proceeding, investigation, examination, or audit directed at a federal agency
- Subject to a subpoena issued in conjunction with proceedings before a grand jury (with the exception of cost reimbursement and the restricted use of grand jury information)
- Requested by a government authority subject to a lawsuit involving the bank customer (The records may be obtained under the Federal Rules of Civil and Criminal Procedure.)

The act also allows financial institutions to

- Release records that are not individually identifiable with a particular customer
- Notify law enforcement officials if it has information relevant to a violation of the law

## Exceptions to Notice Requirements But Not to Certification Requirements

In certain cases, the act does not require the customer to be notified of the request but still requires the federal agency requesting the information to certify in writing that it has complied with all applicable provisions of the act. Exceptions to the notice provisions include

- Instances in which a financial institution, rather than a customer, is being investigated

- Requests for records incidental to the processing of a government loan, loan guaranty, loan insurance agreement, or default on a government-guaranteed or government-insured loan (In this case, the federal agency must give the loan applicant a notice of the government's rights to access financial records when the customer initially applies for the loan. The financial institution is then required to keep a record of all disclosures made to government authorities, and the customer is entitled to inspect this record.)
- Instances in which the government is engaging in authorized foreign intelligence activities or the Secret Service is carrying out its protective functions

Although the Securities and Exchange Commission is covered by the act, it can obtain customer records from an institution without prior notice to the customer by obtaining an order from a U.S. district court. The agency must, however, provide the certificate of compliance to the institution along with the court order prohibiting disclosure of the fact that the documents have been obtained. The court order will set a delay-of-notification date, after which the customer will be notified by the institution that the SEC has obtained his or her records.

## Delayed-Notice Requirements

Under certain circumstances, a government entity may request a court order delaying the customer notice for up to ninety days. This delay may be granted if the court finds that earlier notice would result in endangering the life or physical safety of any person, flight from prosecution, destruction of or tampering with evidence, or intimidation of potential witnesses or would otherwise seriously jeopardize or unduly delay an investigation, trial, or official proceeding. Delayed notice of up to ninety days is also allowed for search warrants.

## Civil Liability

A customer may collect civil penalties from any government agency or department that obtains, or any financial institution or employee of the institution who discloses, information in violation of the act. These penalties include (1) actual damages, (2) \$100, regardless of the volume of records involved, (3) court costs and reasonable attorney's fees, and (4) such punitive damages as the court may allow for willful or intentional violations. An action may be brought up to three years after the date of the violation or the date the violation was discovered. A financial institution that relies in good faith on a federal agency's certification may not be held liable to a customer for the disclosure of financial records.

# Right to Financial Privacy Act Examination Procedures

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1. Determine if the financial institution has received any requests for customer financial records covered by the act since the most recent compliance examination. If no requests have been received, determine if the institution is aware of its responsibilities under the act. If requests have been received, complete the remaining procedures.
2. Determine if the financial institution has established procedures and internal controls for fulfilling requests by government authorities for consumer financial records that are adequate to ensure that all requests are handled in compliance with the act.
3. Determine if the financial institution provides customers' financial records to government authorities only after receiving the written certification required by the act.
4. Determine if the financial institution's internal procedures require that the institution refrain from requiring a customer's authorization for disclosure of financial records as a condition of doing business.
5. Determine if the financial institution keeps appropriate records of those instances in which a customer's financial records are disclosed to a government authority upon authorization by the customer, including a copy of the request and the identity of the government authority. Determine if the institution provides customers a copy of the records upon request (unless a court order blocking access has been obtained).
6. Determine if the financial institution maintains appropriate records of all disclosures of a customer's records made to a government authority in connection with a government loan, guaranty, or insurance program. Determine if the institution allows customers to examine these records upon request.





# Right to Financial Privacy Act Examination Checklist

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|--|-----|----|
| 1. Has the financial institution received any requests for customer financial records covered by the Right to Financial Privacy Act since the last examination?  | Yes | No |
| If it has, answer questions 2–7.   |     |    |
| 2. Has the financial institution, in compliance with the act, established procedures for fulfilling requests by government authorities for customers' financial records?   | Yes | No |
| 3. Does the financial institution have adequate internal controls in place to ensure that all requests are handled in compliance with the act?   | Yes | No |
| 4. As required by section 1103(b) of the act, does the financial institution provide customers' financial records to government authorities only after receiving the written certification required by the act?  | Yes | No |
| 5. Does the financial institution refrain from requiring a customer's authorization for disclosure of financial records as a condition of doing business? (§ 1104(b))  | Yes | No |
| 6. Does the financial institution maintain records of all disclosures of customer records made to a government authority in connection with a government loan, guaranty, or insurance program? (§ 1113(h)(6))  | Yes | No |
| a. Does the financial institution allow customers to examine these records upon request?   | Yes | No |
| 7. Does the financial institution keep adequate records of those instances in which a customer's financial records are disclosed to a government authority upon authorization by the customer, including a copy of the request and the identity of the government authority? (§ 1104(c)) | Yes | No |
| a. Does the financial institution allow customers to examine these records upon request (unless blocked by a court order)?   | Yes | No |
- Each question 2–7 answered “no” requires an explanation of how the financial institution intends to comply with the requirements of the act.



# Protecting Tenants at Foreclosure

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## Background

The Protecting Tenants at Foreclosure Act of 2009<sup>1</sup> became effective on May 20, 2009. This new law protects tenants from immediate eviction by persons or entities that become owners of residential property through the foreclosure process and extends additional protections for tenants with U.S. Department of Housing and Urban Development Section 8 vouchers.<sup>2</sup> The law is self-executing; no federal agency has authority to issue regulations implementing the law or to interpret the law. The law expires on December 31, 2012.

The fundamental purpose of the Protecting Tenants at Foreclosure Act is to ensure that tenants facing eviction from a foreclosed property have adequate time to find alternative housing. To that end, the law establishes a minimum time period that a tenant can remain in a foreclosed property before eviction. The law does not affect any state or

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1. Title VII of the Helping Families Save Their Homes Act of 2009. Public Law 111-22, effective May 20, 2009 ([www.gpo.gov/fdsys/pkg/PLAW-111publ22/pdf/PLAW-111publ22.pdf](http://www.gpo.gov/fdsys/pkg/PLAW-111publ22/pdf/PLAW-111publ22.pdf)).

2. [www.gpo.gov/fdsys/pkg/FR-2009-06-24/pdf/E9-14909.pdf](http://www.gpo.gov/fdsys/pkg/FR-2009-06-24/pdf/E9-14909.pdf) and [www.hud.gov/offices/pih/programs/hcv/about/fact\\_sheet.cfm#6](http://www.hud.gov/offices/pih/programs/hcv/about/fact_sheet.cfm#6)

local law that provides longer time periods or other additional protections for tenants.

## Definitions

### Bona Fide Lease or Tenancy

A lease or tenancy is bona fide if the tenant is not the mortgagor or the parent, spouse, or child of the mortgagor; the lease or tenancy is the result of an arms-length transaction; and the lease or tenancy requires rent that is not substantially lower than fair market rent or is reduced or subsidized due to a federal, state, or local subsidy.

## Requirements

Under the law, the immediate successor in interest at foreclosure must (a) provide bona fide tenants with 90 days notice prior to eviction and (b) allow bona fide tenants with leases to occupy property until the end of the lease term, except the lease can be terminated on 90 days notice if the unit is sold to a purchaser who will occupy the property.



# Protecting Tenants at Foreclosure Examination Objectives and Procedures

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## EXAMINATION OBJECTIVES

1. To assess the institution's awareness of its responsibilities under the Protecting Tenants at Foreclosure Act of 2009.
2. To assess the institution's compliance management policies and procedures with respect to its responsibilities under the law.

## EXAMINATION PROCEDURES

1. Determine that the institution is aware of its responsibilities under the law through interviews with institution management.
2. Determine that the institution has incorporated its compliance responsibilities under the law into its operations, particularly with respect to its foreclosure notice procedures.
3. Determine that the institution has conducted training for appropriate personnel regarding the law.
4. Determine that the institution has incorporated routine reviews for compliance with the law into its compliance monitoring program.
5. Determine that the institution's internal audit program has been updated to include audit plans for evaluating compliance with the law.
6. Review applicable compliance review and audit materials, including workpapers, checklists, and reports pertaining to the law. Evaluate whether the reviews and audits performed were reasonable and accurate and that effective corrective action occurred in response to any identified deficiencies.
7. Summarize findings and supervisory concerns. Identify actions needed to address any weaknesses and deficiencies in the institution's compliance management systems. Discuss findings with institution management and obtain any necessary commitment for corrective action.

# Federal Fair Lending Regulations and Statutes Overview

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The federal fair lending laws—the Equal Credit Opportunity Act and the Fair Housing Act—prohibit discrimination in credit transactions, including transactions related to residential real estate.

## The Statutes and Implementing Regulations

The *Equal Credit Opportunity Act* (ECOA), which is implemented by the Board's Regulation B (12 CFR 202), prohibits discrimination in any aspect of a credit transaction. It applies to any extension of credit, including residential real estate lending and extensions of credit to small businesses, corporations, partnerships, and trusts.

The ECOA prohibits discrimination based on

- Race or color
- Religion
- National origin
- Sex
- Marital status
- Age (provided the applicant has the capacity to contract)
- The applicant's receipt of income derived from any public assistance program
- The applicant's exercise, in good faith, of any right under the Consumer Credit Protection Act

Lending acts and practices that are specifically prohibited, permitted, or required are described in the regulation. Official staff interpretations of the regulation are contained in supplement I to the regulation.

The *Fair Housing Act* (FHAct), which is implemented by HUD regulations,<sup>1</sup> prohibits discrimination in all aspects of residential real estate–related transactions, including, but not limited to,

- Making loans to buy, build, repair, or improve a dwelling
- Purchasing real estate loans
- Selling, brokering, or appraising residential real estate
- Selling or renting a dwelling

The FHAct prohibits discrimination based on

- Race or color
- Religion
- National origin
- Sex
- Familial status (that is, discrimination against households having children under the age of 18 living with a parent or legal custodian, pregnant women, or persons with legal custody of children under 18)
- Handicap

Because both the FHAct and the ECOA apply to mortgage lending, lenders may not discriminate in mortgage lending on the basis of any of the prohibited factors listed. In addition, with respect to residential real estate–related lending, under both laws, a lender may not, on the basis of a prohibited factor,

- Fail to provide information or services relating to, or provide different information or services relating to, any aspect of the lending process, including credit availability, application procedures, and lending standards
- Discourage or selectively encourage applicants with respect to inquiries about or applications for credit
- Refuse to extend credit, or use different standards in determining whether to extend credit
- Vary the terms of credit offered, including the amount, interest rate, duration, and type of loan
- Use different standards to evaluate collateral
- Treat a borrower differently in servicing a loan or invoking default remedies
- Use different standards for pooling or packaging a loan in the secondary market

A lender may not express, orally or in writing, a preference that is based on a prohibited factor or indicate that it will treat applicants differently on the basis of a prohibited factor. Moreover, a lender may not discriminate on a prohibited basis because of the characteristics of

- An applicant, prospective applicant, or borrower
- A person associated with an applicant, prospective applicant, or borrower (for example, a co-applicant, spouse, business partner, or live-in aide)
- The present or prospective occupants of either the property to be financed or the neighborhood or other area in which the property to be financed is located

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Note: This overview is adapted from the introduction to the Interagency Fair Lending Examination Procedures, which were revised in 2004 and distributed by the Board as an attachment to CA Letter 04-8.

1. HUD's regulations are at 24 CFR 100.

Finally, the FHAct requires lenders to make reasonable accommodations for a person with disabilities when such accommodations are necessary to afford the person an equal opportunity to apply for credit.

## Types of Lending Discrimination

The courts have recognized three types of proof of lending discrimination under the ECOA and the FHAct:

- Overt evidence of disparate treatment
- Comparative evidence of disparate treatment
- Evidence of disparate impact

### Disparate Treatment

The existence of illegal disparate treatment may be established either by statements revealing that a lender explicitly considered prohibited factors (*overt evidence*) or by differences in treatment that are not fully explained by legitimate nondiscriminatory factors (*comparative evidence*).

#### *Overt Evidence of Disparate Treatment*

Overt evidence of discrimination exists when a lender openly discriminates on a prohibited basis.

*Example.* A lender offers a credit card with a limit of up to \$750 for applicants age 21–30 and \$1,500 for applicants over 30. This policy violates the ECOA's prohibition on discrimination on the basis of age.

Overt evidence of discrimination also exists even when a lender expresses—but does not act on—a discriminatory preference.

*Example.* A lending officer tells a customer, “We do not like to make home mortgages to Native Americans, but the law says we may not discriminate and we have to comply with the law.” This statement violates the FHAct's prohibition against statements expressing a discriminatory preference as well as section 202.5(a) of Regulation B, which prohibits discouraging applicants on a prohibited basis.

#### *Comparative Evidence of Disparate Treatment*

Disparate treatment occurs when a lender treats a credit applicant differently on the basis of one of the prohibited factors. Showing that, beyond the difference in treatment, the treatment was motivated by prejudice or by conscious intention to discriminate against a person is not required. Different treatment is considered by courts to be intentional discrimi-

nation because the difference in treatment on a prohibited basis has no credible, nondiscriminatory explanation.

Disparate treatment may be more likely to occur in the treatment of applicants who are neither clearly well qualified nor clearly unqualified. Discrimination may more readily affect applicants in this middle group for two reasons. First, applications that are “close cases” have more room and need for lender discretion. Second, whether or not an applicant qualifies may depend on the level of assistance provided by the lender in completing an application. The lender may, for example, propose solutions to credit or other problems relevant to an application, identify compensating factors, and provide encouragement to the applicant. Lenders are under no obligation to provide such assistance, but to the extent that they do, the assistance must be provided in a nondiscriminatory way.

*Example.* A nonminority couple applies for an automobile loan. The lender finds adverse information in the couple's credit report. The lender discusses the credit report with the couple and determines that the adverse information, a judgment against the couple, was incorrect, as the judgment had been vacated. The nonminority couple was granted a loan. A minority couple applied for a similar loan with the same lender. Upon discovering adverse information in the minority couple's credit report, the lender denies the loan application on the basis of the adverse information without giving the couple an opportunity to discuss the report.

The foregoing is an example of disparate treatment of similarly situated applicants—apparently on the basis of a prohibited factor—in the amount of assistance and information provided.

If a lender has apparently treated similar applicants differently on the basis of a prohibited factor, it must explain the difference. If the explanation is found to be not credible, the Federal Reserve may conclude that the lender intentionally discriminated.

*Redlining* is a form of illegal disparate treatment whereby a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located. Redlining may violate both the FHAct and the ECOA.

### Disparate Impact

A disparate impact occurs when a lender applies a racially (or otherwise) neutral policy or practice

equally to all credit applicants but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis.

*Example.* A lender's policy is to deny loan applications for single-family residences for less than \$60,000. The policy has been in effect for ten years. This minimum loan amount policy is shown to disproportionately exclude potential minority applicants from consideration because of their income levels or the value of the houses in the areas in which they live.

Although the law on disparate impact as it applies to lending discrimination continues to develop, it has been clearly established that a policy or practice that creates a disparity on a prohibited basis is not, by itself, proof of a violation.

When an examiner finds that a lender's policy or practice has a disparate impact, the next step is to determine whether the policy or practice is justified by "business necessity." The justification must be manifest and may not be hypothetical or speculative. Factors that may be relevant to the justification include cost and profitability. But even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it may still be found to be in violation if an alternative policy or practice could serve the same purpose with less discriminatory effect. Finally, evidence of *discriminatory intent* is not necessary to establish that a lender's adoption or implementation of a policy or practice that has a disparate impact is in violation of the FHAct or the ECOA.





# Federal Fair Lending Regulations and Statutes Equal Credit Opportunity (Regulation B)

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## Background

The Equal Credit Opportunity Act (ECOA) of 1974, which is implemented by the Board's Regulation B, applies to all creditors. The statute requires financial institutions and other firms engaged in the extension of credit to "make credit equally available to all creditworthy customers without regard to sex or marital status." Moreover, the statute makes it unlawful for "any creditor to discriminate against any applicant with respect to any aspect of a credit transaction (1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract); (2) because all or part of the applicant's income derives from any public assistance program; or (3) because the applicant has in good faith exercised any right under the Consumer Credit Protection Act." In keeping with the broad reach of the prohibition, the regulation covers creditor activities before, during, and after the extension of credit.

Under the ECOA, the Federal Reserve Board is responsible for drafting and interpreting the implementing regulation. Enforcement responsibility, however, rests with a creditor's functional regulator or, for any category not so assigned, with the Federal Trade Commission. A synopsis of some of the more important points of Regulation B follows.

## Prohibited Practices

Regulation B contains two basic and comprehensive prohibitions against discriminatory lending practices (section 202.4):

- A creditor shall not discriminate against an applicant on a prohibited basis regarding any aspect of a credit transaction.
- A creditor shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage, on a prohibited basis, a reasonable person from making or pursuing an application.

Note that the regulation is concerned not only with the treatment of persons who have initiated the application process, but also with lender behavior before the application is even taken. Lending officers and employees must be careful to take no action that would, on a prohibited basis, discourage anyone from applying for a loan. For example, a bank may not advertise its credit services and practices in ways that would tend to encourage some types of borrowers and discourage others on

a prohibited basis. In addition, a bank may not use prescreening tactics likely to discourage potential applicants on a prohibited basis. Instructions to loan officers or brokers to use scripts, rate quotes, or other means to discourage minority applicants from applying for credit are also prohibited.

The prohibition against discouraging applicants applies to in-person oral and telephone inquiries as well as to written applications. Lending officers must refrain from requesting prohibited information in conversations with applicants during the pre-interview phase (that is, before the application is taken) as well as when taking the written application.

To prevent discrimination in the credit-granting process, the regulation imposes a delicate balance between the creditor's need to know as much as possible about a prospective borrower and the borrower's right not to disclose information irrelevant to the credit transaction. To this end, the regulation prescribes rules for taking, evaluating, and acting on applications as well as rules for furnishing and maintaining credit information.

## Rules for Taking Applications— Section 202.5

Regulation B prohibits creditors from requesting and collecting specific personal information about an applicant that has no bearing on the applicant's ability or willingness to repay the credit requested and could be used to discriminate against the applicant.

## Applicant Characteristics

Creditors may not request or collect information about an applicant's race, color, religion, national origin, or sex. Exceptions to this rule generally involve situations in which the information is necessary to test for compliance with fair lending rules or is required by a state or federal regulatory agency or other government entity for a particular purpose, such as to determine eligibility for a particular program. For example, a creditor may request prohibited information

- In connection with a self-test being conducted by the creditor (provided that the self-test meets certain requirements)
- For monitoring purposes in relation to credit secured by real estate
- To determine an applicant's eligibility for special-purpose credit programs

### Information about a Spouse or Former Spouse (§ 202.5(c))

A bank may not request information about an applicant's spouse or former spouse except under the following circumstances:

- The non-applicant spouse will be a user of or joint obligor on the account. (Note: The term "user" applies only to open-end accounts.)
- The non-applicant spouse will be contractually liable on the account.
- The applicant is relying on the spouse's income, at least in part, as a source of repayment.
- The applicant resides in a community property state, or the property upon which the applicant is relying as a basis for repayment of the credit requested is located in such a state.
- The applicant is relying on alimony, child support, or separate maintenance income as a basis for obtaining the credit.

### Marital status (§§ 202.5(d)(1) and 202.5(d)(3))

#### *Individual Credit*

When an applicant applies for individual credit, the bank may not ask the applicant's marital status. There are two exceptions to this rule:

- If the credit transaction is to be secured, the bank may ask the applicant's marital status. (This information may be necessary to determine what would be required to gain access to the collateral in the event of default.)
- If the applicant either resides in a community property state or lists assets to support the debt that are located in such a state, the bank may ask the applicant's marital status. (In community property states, assets owned by a married individual may also be owned by the spouse, thus complicating the accessibility of the collateral in the event of default.)

#### *Joint Credit*

When a request for credit is joint (made by two or more individuals who will be primarily liable), the bank may ask the applicant's marital status, regardless of whether the credit is to be secured or unsecured, but may use only the terms "married," "unmarried," and "separated." This requirement applies to oral as well as written requests for marital status information. "Unmarried" may be defined to include divorced, widowed, or never married, but the application must not be structured in such a way as to encourage the applicant to distinguish among these.

### Alimony, Child Support, or Separate Maintenance Income (§ 202.5(d)(2))

A bank may ask if an applicant is receiving alimony, child support, or separate maintenance payments. However, the bank must first disclose to the applicant that such income need not be revealed unless the applicant wishes to rely on that income in the determination of creditworthiness. An appropriate notice to that effect must be given whenever the bank makes a general request concerning income and the source of that income. Therefore, a bank either must ask questions designed to solicit only information about specific income (for example, "salary," "wages," "employment," or other specified categories of income) or must state that disclosure of alimony, child support, or separate maintenance payments is not required.

### Residency and Immigration Status (§ 202.5(e))

The bank may inquire about the applicant's permanent residence and immigration status in order to determine creditworthiness.

## Rules for Evaluating Applications— Section 202.6

### General Rule

A creditor may consider any information in evaluating applicants, so long as the use of the information does not have the *intent* or the *effect* of discriminating against an applicant on a prohibited basis. Generally, a creditor may not

- Consider any of the prohibited bases, including age (providing the applicant is old enough, under state law, to enter into a binding contract) and the receipt of public assistance
- Use childbearing or childrearing information, assumptions, or statistics to determine whether an applicant's income may be interrupted or decreased
- Consider whether there is a telephone listing in the applicant's name (but the creditor may consider whether there is a telephone in the applicant's home)
- Discount or exclude part-time income from an applicant or the spouse of an applicant

### Systems for Analyzing Credit

Regulation B neither requires nor endorses any particular method of credit analysis. Creditors may use traditional methods, such as judgmental systems that rely on a credit officer's subjective evaluation of an applicant's creditworthiness, or

they may use more-objective, statistically developed techniques such as credit scoring.

### *Credit Scoring Systems*

Section 202.2(p) of Regulation B prescribes the standards that a credit scoring system must meet to qualify as an “empirically derived, demonstrably and statistically sound, credit system.” All forms of credit analysis that do not meet the standards are automatically classified as “judgmental” systems. This distinction is important because creditors that use a “demonstrably and statistically sound” system may take applicant age directly into account as a predictive variable, whereas judgmental systems may not.

### *Judgmental Evaluation Systems*

Any system other than one that is empirically derived and demonstrably and statistically sound is a judgmental system (including any credit scoring system that does not meet the prescribed technical standards). Such a system may not take applicant age directly into account in evaluating creditworthiness. The act and the regulation do, however, permit a creditor to consider the applicant’s age for the purpose of evaluating other applicant information that has a demonstrable relationship to creditworthiness.

## **Rules for Extensions of Credit— Section 202.7**

Section 202.7 of Regulation B provides a set of rules proscribing certain discriminatory practices regarding the creation and continuation of credit accounts.

### **Signature Requirements**

The primary purpose of the signature requirements is to permit creditworthy individuals (particularly women) to obtain credit on their own. Two general rules apply:

- A bank may not require a signature other than the applicant’s or joint applicant’s if under the bank’s standards of creditworthiness the applicant qualifies for the amount and terms of the credit requested.
- A bank has more latitude in seeking signatures on instruments necessary to reach property used as security, or in support of the customer’s creditworthiness, than it has in obtaining the signatures of persons other than the applicant on documents that establish the contractual obligation to repay.

The subsections dealing with signatures have been, for many creditors, some of the most commonly misunderstood provisions of Regulation B. For that reason, and to increase examiners’ ability to facilitate lender compliance and determine whether a particular signature practice is or is not a violation of the regulation, additional guidance is provided in CA Letter 02-1, Clarifying Signature Provisions under Sec. 202.7(d) of Regulation B. Examiners should consult that CA letter when assessing the level of a bank’s compliance with the signature requirements.

## **Special-Purpose Credit Programs— Section 202.8**

The ECOA and Regulation B allow creditors to establish special-purpose credit programs for applicants who meet certain eligibility requirements. Generally, these programs target an economically disadvantaged class of individuals and are authorized by federal or state law. Some are offered by not-for-profit organizations that meet certain IRS guidelines, and some by for-profit organizations that meet specific tests outlined in section 202.8.

Experience has shown that creditors rarely seek to use section 202.8. Additionally, as stated in the commentary (supplement I to the regulation), the Federal Reserve “does not determine whether individual programs qualify for special-purpose credit status, or whether a particular program benefits an ‘economically disadvantaged class of persons.’ The agency or creditor administering or offering the loan program must make these decisions regarding the status of its program.” Consequently, examiners are encouraged, if an issue arises regarding such a program, to consult with Board staff.

## **Notifications—Section 202.9**

A bank must notify an applicant of action taken on the applicant’s request for credit, whether favorable or adverse, within thirty days after receiving a completed application. Notice of approval may be expressly stated or implied (for example, the bank may give the applicant the credit card, money, property, or services for which the applicant applied). Notification of adverse action taken on an *existing* account must also be made within thirty days.

Under at least two circumstances, the bank need not comply with the thirty-day notification rule:

- The bank must notify an applicant of adverse action within ninety days after making a counter-offer unless the applicant accepts or uses the credit during that time.

- The bank may not have to notify an applicant of adverse action if the application was incomplete and the bank sent the applicant a notice of incompleteness that met certain requirements set forth in section 202.9(c).

### Adverse Action Notice (§ 202.9(a)(2))

A notification of adverse action must be in writing and must contain certain information, including the name and address of the bank and the nature of the action that was taken. In addition, the bank must provide an ECOA notice that includes the identity of the federal agency responsible for enforcing compliance with the act for that bank. This notice is generally included on the notification of adverse action. The bank must also either provide the applicant with the specific principal reason for the action taken or disclose that the applicant has the right to request the reason(s) for denial within sixty days of receipt of the bank's notification, along with the name, address, and telephone number of the person who can provide the specific reason(s) for the adverse action. The reason may be given orally if the bank also advises the applicant of the right to obtain the reason in writing upon request.

### Incomplete Applications (§ 202.9(c))

When a bank receives an incomplete application, it may send one of two alternative notifications to the applicant. One is a notice of adverse action; the other is a notice of incompleteness. The notice of incompleteness must be in writing and must specify the information the bank needs if it is to consider the application; it must also provide a reasonable period of time for the applicant to furnish the missing information.

### Applications Submitted through a Third Party (§ 202.9(g))

When more than one bank is involved in a transaction and adverse action is taken with respect to the application for credit by all the banks involved, each bank that took such action must provide a notice of action taken. The notification may be given by a third party; however, the notice must disclose the identity of each bank on whose behalf the notice is given. If one of the banks approves the application, the banks that took adverse action need not provide notification.

### Notification to Business Credit Applicants (§ 202.9(a)(3))

The notification requirements for business credit applicants are different from those for consumer credit applicants and are more extensive if the

business had gross revenues of \$1,000,000 or less in the preceding fiscal year. Extensions of trade credit, credit incident to a factoring agreement, and similar types of credit are subject to the same rules as those that apply to businesses that had gross revenues of more than \$1,000,000.

Generally, a bank must comply with the same notification requirements for business credit applicants with gross revenues of \$1,000,000 or less as it does for consumer credit applicants. However, the bank has more options when dealing with these business credit applicants. First, the bank may tell the business credit applicant orally of the action taken. Second, if the bank chooses to provide a notice informing the business credit applicant of the right to request the reason for action taken, it may, rather than disclose the reason itself, provide the notice at the time of application. If the bank chooses to inform the applicant of the right to request a reason, however, it must provide a disclosure with an ECOA notice that is in retainable form and that gives the applicant the same information that must be provided to consumer credit applicants when this option is used (see section 202.9(a)(2)(ii)). Finally, if the application was made entirely over the phone, the bank may provide an oral statement of action taken and of the applicant's right to a statement of reasons for adverse action.

The notification requirements for business credit applicants with gross revenues of more than \$1,000,000 are relatively simple. The bank must notify the applicant of the action taken within a reasonable time period. The notice may be oral or in writing; a written statement of the reasons for adverse action and the ECOA notice need be provided only if the applicant makes a written request within sixty days of the bank's notification of the action taken.

### Designation of Accounts— Section 202.10(a)

A creditor that furnishes credit information to a consumer reporting agency must designate

- Any new account to reflect the participation of both spouses if the applicant's spouse is permitted to use or is contractually liable on the account
- Any existing account to reflect the participation of both spouses within ninety days after receiving a written request to do so from one of the spouses

If a creditor furnishes credit information to a consumer reporting agency, the creditor must furnish the information in the name of the spouse about whom the information was requested.

## Record Retention—Section 202.12

### Applications

In general, a bank must preserve all written or recorded information connected with an application for twenty-five months (twelve months for business credit) after the date on which the bank informed the applicant of action taken on an application or of incompleteness of an application.

### Prohibited Information

A bank may retain information in its files that it may not use in evaluating applications. However, the information must have been obtained inadvertently or in accordance with federal or state law or regulation.

### Existing Accounts

A bank must preserve any written or recorded information concerning adverse action on an existing account as well as any written statement submitted by the applicant alleging a violation of the ECOA or Regulation B. This evidence must be kept for twenty-five months (twelve months for business credit).

### Prescreened Solicitations

The twenty-five-month retention rule also applies when a bank makes an offer of credit to potential customers. In such cases, the bank must retain for twenty-five months following the date of the solicitation

- The text of any prescreened solicitation,
- The list of criteria the creditor used to select potential recipients of the solicitation, and
- Any correspondence related to complaints (formal or informal) about the solicitation.

## Rules for Providing Appraisal Reports—Section 202.14

Regulation B requires that banks provide a copy of the appraisal report used in connection with an application for credit to be secured by a lien on a dwelling. A bank may provide the copy either routinely (whether or not credit is granted or the application is withdrawn) or upon an applicant's written request. If the bank provides an appraisal report only upon request, it must inform the applicant in writing of the right to receive a copy of the report.

## Incentives for Self-Testing and Self-Correction—Section 202.15

A self-test, as discussed in section 202.15 of Regulation B, must meet two criteria. First, it must be a program, practice, or study that a lender designs and uses specifically to determine the extent or effectiveness of its compliance with the regulation. Second, the results of the self-test must create data or factual information that is otherwise not available and cannot be derived from loan or application files or other records related to credit transactions. The findings of a self-test that is conducted voluntarily by a creditor and that meets the conditions set forth in section 202.15 are privileged against discovery or use by (1) a government agency in any examination or investigation related to the ECOA or Regulation B or (2) a government agency or an applicant in any legal proceeding involving an alleged violation of the ECOA or Regulation B. Privileged information includes the report or results of the test; data or other information created by the test; and any analysis, opinions, or conclusions regarding the results of the test. The privilege does *not* cover information about whether a test was conducted; the methodology, scope, time period, or dates covered by the test; loan or application files or other business records; and information derived from such files and records, even if aggregated, summarized, or reorganized.

## Requirements for Electronic Communication—Section 202.16

Subject to the specific provisions of section 202.16 regarding disclosures, consumer consent, redelivery, electronic signatures, and exceptions, a creditor may provide by electronic communication any disclosure otherwise required by the regulation to be in writing.

## Enforcement, Penalties, and Liabilities—Section 202.17

In addition to actual damages, Regulation B provides for punitive damages of up to \$10,000 in individual lawsuits and up to the lesser of \$500,000 or 1 percent of the bank's net worth in class action suits. Successful complainants are also entitled to an award of court costs and attorney's fees.

A bank is not liable for failure to comply with the notification requirements of section 202.9 if the failure was caused by an inadvertent error and the bank, after discovering the error, (1) corrects the error as soon as possible and (2) begins compliance with the requirements of the regulation. "Inadvertent errors" include mechanical, elec-

tronic, and clerical errors that the bank can show (1) were not intentional and (2) occurred despite the fact that the bank maintains procedures reasonably adapted to avoid such errors. Similarly, failure to comply with sections 202.6(b)(6), 202.10,

202.12, and 202.13 is not considered a violation if it results from an inadvertent error and the bank takes the corrective action noted above. Errors involving sections 202.12 and 202.13 may be corrected prospectively by the bank.

# Federal Fair Lending Regulations and Statutes

## Fair Housing Act

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The Fair Housing Act (FHA), which is title VIII of the Civil Rights Act of 1968, as amended (42 USC 3601 et seq.), makes it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap, or familial status. Anyone who is in the business of providing housing-related loans is subject to the FHA (as well as the Equal Credit Opportunity Act).

### Key Provisions of the Fair Housing Act

The Fair Housing Act specifically applies to the financing of a loan secured by residential real estate. As noted in section 805 of the act, a bank may not deny a loan or other financial assistance for the purpose of purchasing, constructing, improving, repairing, or maintaining a dwelling because of the race, color, religion, national origin, handicap, familial status, or sex of the

- Loan applicant
- Any person associated with the loan applicant
- Any current or prospective owner of the dwelling
- Any lessees
- Any tenants or occupants

The FHA also makes it unlawful for a creditor to use a prohibited basis to discriminate in fixing the amount, interest rates, duration, or other terms of the credit. In addition, because residential real estate-related transactions include any transactions secured by residential real estate, the act's prohibitions (and regulatory requirements in certain areas, such as advertising) apply to home equity lines of credit as well as to home purchase loans. These prohibitions also apply to the selling, renting, brokering, or appraising of residential real property and to secondary-mortgage-market activities. Consequently, a bank's practices in the area of housing lending should be examined in a general way to ensure that they do not "otherwise make unavailable or deny" housing, even when no specific act or practice may violate any specifically named prohibition of the FHA.

### Unlawfully Discriminatory Lending Practices under the FHA

Like the other civil rights statutes, the Fair Housing Act was broadly written by Congress. A variety of

lending practices have been found to be illegal under the act, including some that are not specifically mentioned in the act but that have been determined to be illegal because they violate requirements and prohibitions that are implicit in the act's language. Some of the practices that the courts have determined to be prohibited are described below.

### Redlining

*Redlining* is the practice of denying a creditworthy applicant a loan for housing in a certain neighborhood even though the applicant may otherwise be eligible for the loan. The term refers to the presumed practice of mortgage lenders of drawing red lines around portions of a map to indicate areas or neighborhoods in which they do not want to make loans.

Redlining on a racial basis has been held by the courts to be an illegal practice. It is unlawful under the FHA only when done on a prohibited basis. Redlining an area on the basis of such considerations as the fact that the area lies on a fault line or a flood plain is not prohibited.

The prohibition against redlining does not mean that a lending institution is expected to approve all housing loan applications or to make all loans on identical terms. Denying loans or granting loans on more-stringent terms and conditions, however, must be justified on the basis of economic factors and without regard to the race, color, religion, national origin, sex, or marital status of the prospective borrowers or the residents of the neighborhood in which the property is located. For example, a bank may consider such economic factors as

- An applicant's income or credit history
- The condition, use, or design of the proposed security property (or of those nearby properties that clearly affect the value of the proposed security property), provided that such determinants are strictly economic or physical in nature
- The availability of neighborhood amenities or city services
- The need of the lender to hold a balanced real estate loan portfolio, with a reasonable distribution of loans among various neighborhoods, types of property, and loan amounts

Each of the factors must be applied without regard to any of the prohibited bases.



## Lowballing

*Lowballing*—the practice of making an excessively low appraisal in relation to the purchase price on the basis of prohibited considerations—is one form of redlining. Lending more than the appraised value of the collateral is not sound banking practice, and lowballing forces a borrower either to cancel the purchase contract or the loan application, or both, or to make a larger down payment on a property in order to make up the difference between the sales price and the appraised price.

## Use of Racially Exclusive Images

The use of racially exclusive images has repeatedly been found to be illegal in the employment context even when there was little or no evidence of a discriminatory policy directed toward any given individual applicant. This practice has been held to violate the Fair Housing Act as well. For example, a housing lender might exploit an exclusive image by showing only applicants of a particular race in advertisements for home loans. Using only white individuals in advertisements for home equity loans, for instance, may suggest to viewers that only white applicants need apply or that the lender is looking only for applicants who resemble the individuals in its housing advertisements.

In addition to prohibiting the use of racially exclusive images, the FHOA makes it unlawful to make or print a statement or advertisement with respect to the sale or rental of a dwelling that indicates a preference, limitation, or discrimination based on race, color, religion, sex, handicap, familial status, or national origin or the intention to make any such preference, limitation, or discrimination. The courts have applied this prohibition to newspaper advertisements soliciting tenants and homebuyers who speak only certain languages. For example, a Korean bank that advertises only in Korean-language publications targeting Koreans while ignoring other minority groups in the bank's community may be discouraging other minority applicants from applying. Although it is recognized that a determination of the impact of an advertising policy will depend on all the facts of the situation, some advertising guidelines issued by the Secretary of the Department of Housing and Urban Development may be useful to banks and examiners in determining the kinds of advertising practices that should be encouraged or avoided. Banks should ensure that their advertising policies do not have the effect, even inadvertently, of prescreening applications for credit on prohibited bases.

## Discriminatory Acts That Have a Negative Impact on Nonminorities

The courts have held that discriminatory acts that have a negative impact on nonminorities, such as white individuals, are illegal and that such individuals have standing to sue.

## Use of Excessively Burdensome Qualification Standards

The use of excessively burdensome qualification standards to deny, or that have the effect of denying, housing to minority applicants is also illegal under the FHOA.

## Imposition of More-Onerous Interest Rates or Other Terms, Conditions, or Requirements

The imposition of more-onerous interest rates, or other more-onerous terms, conditions, or requirements, on minority loan applicants is explicitly prohibited. The phrase "terms or conditions" as used in the act covers many types of discriminatory practices.

## Application of Different Standards or Procedures for the Same Process

The application of different standards or procedures in administering foreclosures, late charges, penalties, reinstatements, or other collection procedures is unlawful.

## Insurance

The FHOA and the ECOA diverge on the treatment of discrimination in the terms or availability of insurance. The ECOA does not prohibit a creditor who sells or participates in the sale of insurance from differentiating, on a prohibited basis, in the terms and availability of insurance. Nor does it prohibit discrimination in the availability or terms of credit on the basis that insurance is unavailable, except when the insurance has been denied on the basis of age. When it comes to housing-related lending, however, the result may be different. The Department of Justice has taken the position that the FHOA is violated when insurance required for housing credit is denied, or is made more difficult to obtain, on a basis prohibited by the FHOA.

## Racial Steering

*Racial steering*—deliberately guiding loan applicants or potential purchasers toward or away from certain types of loans or geographic areas because of race—is illegal.

In summary, banks are not expected to make unsound real estate loans or to render services on

more-favorable terms to applicants solely because of the applicant's status as a member of a protected class. However, denying loans or services on this basis is illegal.



# Federal Fair Lending Regulations and Statutes

## Interagency Fair Lending Examination Procedures

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### INTRODUCTION

#### Overview of Fair Lending Laws and Regulations

This overview provides a basic and abbreviated discussion of federal fair lending laws and regulations. It is adapted from the Interagency Policy Statement on Fair Lending issued in March 1994.

#### 1. Lending Discrimination Statutes and Regulations

The Equal Credit Opportunity Act (ECOA) prohibits discrimination in any aspect of a credit transaction. It applies to any extension of credit, including extensions of credit to small businesses, corporations, partnerships, and trusts.

The ECOA prohibits discrimination based on:

- Race or color
- Religion
- National origin
- Sex
- Marital status
- Age (provided the applicant has the capacity to contract)
- The applicant's receipt of income derived from any public assistance program
- The applicant's exercise, in good faith, of any right under the Consumer Credit Protection Act

The Federal Reserve Board's Regulation B, found at 12 CFR part 202, implements the ECOA. Regulation B describes lending acts and practices that are specifically prohibited, permitted, or required. Official staff interpretations of the regulation are found in Supplement I to 12 CFR part 202.

The Fair Housing Act (FHA) prohibits discrimination in all aspects of "residential real-estate related transactions," including but not limited to:

- Making loans to buy, build, repair or improve a dwelling
- Purchasing real estate loans
- Selling, brokering, or appraising residential real estate
- Selling or renting a dwelling

The FHA prohibits discrimination based on:

- Race or color

- National origin
- Religion
- Sex
- Familial status (defined as children under the age of 18 living with a parent or legal custodian, pregnant women, and people securing custody of children under 18)
- Handicap

HUD's regulations implementing the FHA are found at 24 CFR Part 100. Because both the FHA and the ECOA apply to mortgage lending, lenders may not discriminate in mortgage lending based on any of the prohibited factors in either list.

Under the ECOA, it is unlawful for a lender to discriminate on a prohibited basis in any aspect of a credit transaction, and under both the ECOA and the FHA, it is unlawful for a lender to discriminate on a prohibited basis in a residential real-estate-related transaction. Under one or both of these laws, a lender may not, because of a prohibited factor

- Fail to provide information or services or provide different information or services regarding any aspect of the lending process, including credit availability, application procedures, or lending standards
- Discourage or selectively encourage applicants with respect to inquiries about or applications for credit
- Refuse to extend credit or use different standards in determining whether to extend credit
- Vary the terms of credit offered, including the amount, interest rate, duration, or type of loan
- Use different standards to evaluate collateral
- Treat a borrower differently in servicing a loan or invoking default remedies
- Use different standards for pooling or packaging a loan in the secondary market.

A lender may not express, orally or in writing, a preference based on prohibited factors or indicate that it will treat applicants differently on a prohibited basis. A violation may still exist even if a lender treated applicants equally.

A lender may not discriminate on a prohibited basis because of the characteristics of

- An applicant, prospective applicant, or borrower
- A person associated with an applicant, prospective applicant, or borrower (for example, a

co-applicant, spouse, business partner, or live-in aide)

- The present or prospective occupants of either the property to be financed or the characteristics of the neighborhood or other area where property to be financed is located.

Finally, the FHAct requires lenders to make reasonable accommodations for a person with disabilities when such accommodations are necessary to afford the person an equal opportunity to apply for credit.

## 2. Types of Lending Discrimination

The courts have recognized three methods of proof of lending discrimination under the ECOA and the FHAct:

- Overt evidence of disparate treatment
- Comparative evidence of disparate treatment
- Evidence of disparate impact

### *Disparate Treatment*

The existence of illegal disparate treatment may be established either by statements revealing that a lender explicitly considered prohibited factors (overt evidence) or by differences in treatment that are not fully explained by legitimate nondiscriminatory factors (comparative evidence).

#### **Overt Evidence of Disparate Treatment**

There is overt evidence of discrimination when a lender openly discriminates on a prohibited basis.

*Example:* A lender offered a credit card with a limit of up to \$750 for applicants aged 21–30 and \$1500 for applicants over 30. This policy violated the ECOA's prohibition on discrimination based on age.

There is overt evidence of discrimination even when a lender expresses—but does not act on—a discriminatory preference:

*Example:* A lending officer told a customer, "We do not like to make home mortgages to Native Americans, but the law says we cannot discriminate and we have to comply with the law." This statement violated the FHAct's prohibition on statements expressing a discriminatory preference as well as Section 202.4(b) of Regulation B, which prohibits discouraging applicants on a prohibited basis.

#### **Comparative Evidence of Disparate Treatment**

Disparate treatment occurs when a lender treats a credit applicant differently based on one of the prohibited bases. It does not require any showing that the treatment was motivated by prejudice or a

conscious intention to discriminate against a person beyond the difference in treatment itself.

Disparate treatment may more likely occur in the treatment of applicants who are neither clearly well-qualified nor clearly unqualified. Discrimination may more readily affect applicants in this middle group for two reasons. First, if the applications are "close cases," there is more room and need for lender discretion. Second, whether or not an applicant qualifies may depend on the level of assistance the lender provides the applicant in completing an application. The lender may, for example, propose solutions to credit or other problems regarding an application, identify compensating factors, and provide encouragement to the applicant. Lenders are under no obligation to provide such assistance, but to the extent that they do, the assistance must be provided in a nondiscriminatory way.

*Example:* A non-minority couple applied for an automobile loan. The lender found adverse information in the couple's credit report. The lender discussed the credit report with them and determined that the adverse information, a judgment against the couple, was incorrect because the judgment had been vacated. The non-minority couple was granted their loan. A minority couple applied for a similar loan with the same lender. Upon discovering adverse information in the minority couple's credit report, the lender denied the loan application on the basis of the adverse information without giving the couple an opportunity to discuss the report.

The foregoing is an example of disparate treatment of similarly situated applicants, apparently based on a prohibited factor, in the amount of assistance and information the lender provided.

If a lender has apparently treated similar applicants differently on the basis of a prohibited factor, it must provide an explanation for the difference in treatment. If the lender's explanation is found to be not credible, the agency may find that the lender discriminated.

*Redlining* is a form of illegal disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located. Redlining may violate both the FHAct and the ECOA.

### *Disparate Impact*

When a lender applies a racially or otherwise neutral policy or practice equally to all credit

applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis, the policy or practice is described as having a “disparate impact.”

*Example:* A lender’s policy is not to extend loans for single family residences for less than \$60,000.00. This policy has been in effect for ten years. This minimum loan amount policy is shown to disproportionately exclude potential minority applicants from consideration because of their income levels or the value of the houses in the areas in which they live.

The fact that a policy or practice creates a disparity on a prohibited basis is not alone proof of a violation. When an Agency finds that a lender’s policy or practice has a disparate impact, the next step is to seek to determine whether the policy or practice is justified by “business necessity.” The justification must be manifest and may not be hypothetical or speculative. Factors that may be relevant to the justification could include cost and profitability. Even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it still may be found to be in violation if an alternative policy or practice could serve the same purpose with less discriminatory effect. Finally, evidence of discriminatory intent is not necessary to establish that a lender’s adoption or implementation of a policy or practice that has a disparate impact is in violation of the FHAct or ECOA.

These procedures do not call for examiners to plan examinations to identify or focus on potential disparate impact issues. The guidance in this Introduction is intended to help examiners recognize fair lending issues that may have a potential disparate impact. Guidance in the Appendix to the Interagency Fair Lending Examination Procedures provides details on how to obtain relevant information regarding such situations along with methods of evaluation, as appropriate.

## General Guidelines

These procedures are intended to be a basic and flexible framework to be used in the majority of fair lending examinations conducted by the FFIEC agencies. They are also intended to guide examiner judgment, not to supplant it. The procedures can be augmented by each agency as necessary to ensure their effective implementation.

While these procedures apply to many examinations, agencies routinely use statistical analyses or other specialized techniques in fair lending examinations to assist in evaluating whether a prohibited basis was a factor in an institution’s credit decisions. Examiners should follow the procedures

provided by their respective agencies in these cases.

For a number of aspects of lending—for example, credit scoring and loan pricing—the “state of the art” is more likely to be advanced if the agencies have some latitude to incorporate promising innovations. These interagency procedures provide for that latitude.

Any references in these procedures to options, judgment, etc., of “examiners” means discretion within the limits provided by that examiner’s agency. An examiner should use these procedures in conjunction with his or her own agency’s priorities, examination philosophy, and detailed guidance for implementing these procedures. These procedures should not be interpreted as providing an examiner greater latitude than his or her own agency would. For example, if an agency’s policy is to review compliance management systems in all of its institutions, an examiner for that agency must conduct such a review rather than interpret Part II of these interagency procedures as leaving the review to the examiner’s option.

The procedures emphasize racial and national origin discrimination in residential transactions, but the key principles are applicable to other prohibited bases and to nonresidential transactions.

Finally, these procedures focus on analyzing institution compliance with the broad, nondiscrimination requirements of the ECOA and the FHAct. They do not address such explicit or technical compliance provisions as the signature rules or adverse action notice requirements in Sections 202.7 and 202.9, respectively, of Regulation B.

## PART I. EXAMINATION SCOPE GUIDELINES

### Background

The scope of an examination encompasses the loan product(s), market(s), decision center(s), time frame, and prohibited basis and control group(s) to be analyzed during the examination. These procedures refer to each potential combination of those elements as a “focal point.” Setting the scope of an examination involves, first, identifying all of the potential focal points that appear worthwhile to examine. Then, from among those, examiners select the focal point(s) that will form the scope of the examination, based on risk factors, priorities established in these procedures or by their respective agencies, the record from past examinations, and other relevant guidance. This phase includes obtaining an overview of an institution’s compliance management system as it relates to fair lending.

When selecting focal points for review, examin-

ers may determine that the institution has performed “self-tests” or “self-evaluations” related to specific lending products. The difference between “self tests” and “self evaluations” is discussed in the *Using Self-Tests and Self-Evaluations to Streamline the Examination* section of the Appendix. Institutions must share all information regarding “self-evaluations” and certain limited information related to “self-tests.” Institutions may choose to voluntarily disclose additional information about “self-tests.” Examiners should make sure that institutions understand that voluntarily sharing the results of self-tests will result in a loss of confidential status of these tests. Information from “self-evaluations” or “self-tests” may allow the scoping to be streamlined. Refer to *Using Self-Tests and Self-Evaluations to Streamline the Examination* in the Appendix for additional details.

Scoping may disclose the existence of circumstances—such as the use of credit scoring or a large volume of residential lending—which, under an agency’s policy, call for the use of regression analysis or other statistical methods of identifying potential discrimination with respect to one or more loan products. Where that is the case, the agency’s specialized procedures should be employed for such loan products rather than the procedures set forth below.

Setting the intensity of an examination means determining the breadth and depth of the analysis that will be conducted on the selected loan product(s). This process entails a more involved analysis of the institution’s compliance risk management processes, particularly as it relates to selected products, to reach an informed decision regarding how large a sample of files to review in any transactional analyses performed and whether certain aspects of the credit process deserve heightened scrutiny.

Part I of these procedures provides guidance on establishing the scope of the examination. Part II (Compliance Management Review) provides guidance on determining the intensity of the examination. There is naturally some interdependence between these two phases. Ultimately the scope and intensity of the examination will determine the record of performance that serves as the foundation for agency conclusions about institutional compliance with fair lending obligations. The examiner should employ these procedures to arrive at a well-reasoned and practical conclusion about how to conduct a particular institution’s examination of fair lending performance.

In certain cases where an agency already possesses information which provides examiners with guidance on priorities and risks for planning an upcoming examination, such information may expedite the scoping process and make it unne-

cessary to carry out all of the steps below. For example, the report of the previous fair lending examination may have included recommendations for the focus of the next examination. However, examiners should validate that the institution’s operational structure, product offerings, policies and risks have not changed since the prior examination before condensing the scoping process.

The scoping process can be performed either off-site, onsite, or both, depending on whatever is determined appropriate and feasible. In the interest of minimizing burdens on both the examination team and the institution, requests for information from the institution should be carefully thought out so as to include only the information that will clearly be useful in the examination process. Finally, any off-site information requests should be made sufficiently in advance of the on-site schedule to permit institutions adequate time to assemble necessary information and provide it to the examination team in a timely fashion. (See “Potential Scoping Information” in the Appendix for guidance on additional information that the examiner might wish to consider including in a request).

Examiners should focus the examination based on:

- An understanding of the credit operations of the institution
- The risk that discriminatory conduct may occur in each area of those operations
- The feasibility of developing a factually reliable record of an institution’s performance and fair lending compliance in each area of those operations.

## 1. Understanding Credit Operations

Before evaluating the potential for discriminatory conduct, the examiner should review sufficient information about the institution and its market to understand the credit operations of the institution and the representation of prohibited basis group residents within the markets where the institution does business. The level of detail to be obtained at this stage should be sufficient to identify whether any of the risk factors in the steps below are present. Relevant background information includes:

- The types and terms of credit products offered, differentiating among broad categories of credit such as residential, consumer, or commercial, as well as product variations within such categories (fixed vs. variable, etc.)
- Whether the institution has a special purpose credit program, or other program that is specifi-

cally designed to assist certain underserved populations

- The volume of, or growth in, lending for each of the credit products offered
- The demographics (i.e., race, national origin, etc.) of the credit markets in which the institution is doing business
- The institution's organization of its credit decision-making process, including identification of the delegation of separate lending authorities and the extent to which discretion in pricing or setting credit terms and conditions is delegated to various levels of managers, employees or independent brokers or dealers
- The institution's loan officer or broker compensation program
- The types of relevant documentation/data that are available for various loan products and what is the relative quantity, quality and accessibility of such information. i.e., for which loan product(s) will the information available be most likely to support a sound and reliable fair lending analysis
- The extent to which information requests can be readily organized and coordinated with other compliance examination components to reduce undue burden on the institution. (Do not request more information than the exam team can be expected to utilize during the anticipated course of the examination.)

In thinking about an institution's credit markets, the examiner should recognize that these markets may or may not coincide with an institution's Community Reinvestment Act (CRA) assessment area(s). Where appropriate, the examiner should review the demographics for a broader geographic area than the assessment area.

Where an institution has multiple underwriting or loan processing centers or subsidiaries, each with fully independent credit-granting authority, consider evaluating each center and/or subsidiary separately, provided a sufficient number of loans exist to support a meaningful analysis. In determining the scope of the examination for such institutions, examiners should consider whether:

- Subsidiaries should be examined. The agencies will hold a financial institution responsible for violations by its direct subsidiaries, but not typically for those by its affiliates (unless the affiliate has acted as the agent for the institution or the violation by the affiliate was known or should have been known to the institution before it became involved in the transaction or purchased the affiliate's loans). When seeking to determine an institution's relationship with affiliates that are not supervised financial institutions, limit the inquiry to what can be learned in the

institution and do not contact the affiliate without prior consultation with agency staff.

- The underwriting standards and procedures used in the entity being reviewed are used in related entities not scheduled for the planned examination. This will help examiners to recognize the potential scope of policy-based violations.
- The portfolio consists of applications from a purchased institution. If so, for scoping purposes, examiners should consider the applications as if they were made to the purchasing institution. For comparison purposes, applications evaluated under the *purchased* institution's standards should not be compared to applications evaluated under the *purchasing* institution's standards.).
- The portfolio includes purchased loans. If so, examiners should look for indications that the institution specified loans to purchase based on a prohibited factor or caused a prohibited factor to influence the origination process.
- A complete decision can be made at one of the several underwriting or loan processing centers, each with independent authority. In such a situation, it is best to conduct on-site a separate comparative analysis at each underwriting center. If covering multiple centers is not feasible during the planned examination, examiners should review their processes and internal controls to determine whether or not expanding the scope and/or length of the examination is justified.
- Decision-making responsibility for a single transaction may involve more than one underwriting center. For example, an institution may have authority to decline mortgage applicants, but only the mortgage company subsidiary may approve them. In such a situation, examiners should learn which standards are applied in each entity and the location of records needed for the planned comparisons.
- Applicants can be steered from the financial institution to the subsidiary or other lending channel and vice versa, and what policies and procedures exist to monitor this practice.
- Any third parties, such as brokers or contractors, are involved in the credit decision and how responsibility is allocated among them and the institution. The institution's familiarity with third party actions may be important, for an institution may be in violation if it participates in transactions in which it knew or reasonably ought to have known other parties were discriminating.

As part of understanding the financial institution's own lending operations, it is also important to understand any dealings the financial institution



has with affiliated and non-affiliated mortgage loan brokers and other third party lenders.

These brokers may generate mortgage applications and originations solely for a specific financial institution or may broadly gather loan applications for a variety of local, regional, or national lenders. As a result, it is important to recognize what impact these mortgage brokers and other third party lender actions and application processing operations have on the lending operations of a financial institution. Because brokers can be located anywhere in or out of the financial institution's primary lending or CRA assessment areas, it is important to evaluate broker activity and fair lending compliance related to underwriting, terms and conditions, redlining, and steering, each of which is covered in more depth in sections of these procedures. Examiners should consult with their respective agencies for specific guidance regarding broker activity.

If the institution is large and geographically diverse, examiners should select only as many markets or underwriting centers as can be reviewed readily in depth, rather than selecting proportionally to cover every market. As needed, examiners should narrow the focus to the Metropolitan Statistical Area (MSA) or underwriting center(s) that are determined to present the highest discrimination risk. Examiners should use Loan Application Register (LAR) data organized by underwriting center, if available. After calculating denial rates between the control and prohibited basis groups for the underwriting centers, examiners should select the centers with the highest fair lending risk. This approach would also be used when reviewing pricing or other terms and conditions of approved applicants from the prohibited basis and control groups. If underwriting centers have fewer than five racial or national origin denials, examiners should not examine for racial discrimination in underwriting. Instead, they should shift the focus to other loan products or prohibited bases, or examination types such as a pricing examination.

However, if examiners learn of other indications of risks that favor analyzing a prohibited basis with fewer transactions than the minimum in the sample size tables, they should consult with their supervisory office on possible alternative methods of analysis. For example, there is strong reason to examine a pattern in which almost all of 19 male borrowers received low rates but almost all of four female borrowers received high rates, even though the number of each group is fewer than the stated minimum. Similarly, there would be strong reason to examine a pattern in which almost all of 100 control group applicants were approved but all four prohibited basis group applicants were not, even

though the number of prohibited basis denials was fewer than five.

## 2. Evaluating the Potential for Discriminatory Conduct

### Step One: Develop an Overview

Based on his or her understanding of the credit operations and product offerings of an institution, an examiner should determine the nature and amount of information required for the scoping process and should obtain and organize that information. No single examination can reasonably be expected to evaluate compliance performance as to every prohibited basis, in every product, or in every underwriting center or subsidiary of an institution. In addition to information gained in the process of Understanding Credit Operations, above, the examiner should keep in mind the following factors when selecting products for the scoping review:

- Which products and prohibited bases were reviewed during the most recent prior examination(s) and, conversely, which products and prohibited bases have not recently been reviewed?
- Which prohibited basis groups make up a significant portion of the institution's market for the different credit products offered?
- Which products and prohibited basis groups the institution reviewed using either a voluntarily disclosed self-test or a self evaluation?

Based on consideration of the foregoing factors, the examiner should request information for all residential and other loan products considered appropriate for scoping in the current examination cycle. In addition, wherever feasible, examiners should conduct preliminary interviews with the institution's key underwriting personnel and those involved with establishing the institution's pricing policies and practices. Using the accumulated information, the examiner should evaluate the following, as applicable:

- Underwriting guidelines, policies, and standards
- Descriptions of credit scoring systems, including a list of factors scored, cutoff scores, extent of validation, and any guidance for handling overrides and exceptions. (Refer to *Part A* of the *Considering Automated Underwriting and Credit Scoring* section of the Appendix for guidance)
- Applicable pricing policies, risk-based pricing models, and guidance for exercising discretion over loan terms and conditions
- Descriptions of any compensation system, including whether compensation is related to, loan production or pricing

- The institution's formal and informal relationships with any finance companies, subprime mortgage or consumer lending entities, or similar institutions
- Loan application forms
- Home Mortgage Disclosure Act–Loan Application Register (HMDA–LAR) or loan registers and lists of declined applications
- Description(s) of databases maintained for loan product(s) to be reviewed
- Records detailing policy exceptions or overrides, exception reporting and monitoring processes
- Copies of any consumer complaints alleging discrimination and related loan files
- Compliance program materials (particularly fair lending policies), training manuals, organization charts, as well as record keeping, monitoring protocols, and internal controls
- Copies of any available marketing materials or descriptions of current or previous marketing plans or programs or pre-screened solicitations.

### Step Two: Identify Compliance Program Discrimination Risk Factors

Review information from agency examination work papers, institutional records and any available discussions with management representatives in sufficient detail to understand the organization, staffing, training, recordkeeping, auditing, policies and procedures of the institution's fair lending compliance systems. Review these systems and note the following risk factors:

- C1. Overall institution compliance record is weak.
- C2. Prohibited basis monitoring information required by applicable laws and regulations is nonexistent or incomplete.
- C3. Data and/or recordkeeping problems compromised reliability of previous examination reviews.
- C4. Fair lending problems were previously found in one or more institution products or in institution subsidiaries.
- C5. The size, scope, and quality of the compliance management program, including senior management's involvement, designation of a compliance officer, and staffing is materially inferior to programs customarily found in institutions of similar size, market demographics and credit complexity.
- C6. The institution has not updated compliance policies and procedures to reflect changes in law or in agency guidance.

C7. Fair lending training is nonexistent or weak.

Consider these risk factors and their impact on particular lending products and practices as you conduct the product specific risk review during the scoping steps that follow. Where this review identifies fair lending compliance system deficiencies, give them appropriate consideration as part of the Compliance Management Review in Part II of these procedures.

### Step Three: Review Residential Loan Products

Although home mortgages may not be the ultimate subject of every fair lending examination, this product line must at least be considered in the course of scoping every institution that is engaged in the residential lending market.

Divide home mortgage loans into the following groupings: home purchase, home improvement, and refinancings. Subdivide those three groups further if an institution does a significant number of any of the following types or forms of residential lending, and consider them separately:

- Government-insured loans
- Mobile home or manufactured housing loans
- Wholesale, indirect and brokered loans
- Portfolio lending (including portfolios of Fannie Mae/Freddie Mac rejections)

In addition, determine whether the institution offers any conventional "affordable" housing loan programs special purpose credit programs or other programs that are specifically designed to assist certain borrowers, such as underserved populations and whether their terms and conditions make them incompatible with regular conventional loans for comparative purposes. If so, consider them separately.

If previous examinations have demonstrated the following, then an examiner may limit the focus of the current examination to alternative underwriting or processing centers or to other residential products that have received less scrutiny in the past:

- A strong fair lending compliance program
- No record of discriminatory transactions at particular decision centers or in particular residential products
- No indication of a significant change in personnel, operations or underwriting or pricing policies at those centers or in those residential products
- No unresolved fair lending complaints, administrative proceedings, litigation or similar factors.
- No discretion to set price or credit terms and

conditions in particular decision centers or for particular residential products.

#### Step Four: Identify Residential Lending Discrimination Risk Factors

- Review the lending policies, marketing plans, underwriting, appraisal and pricing guidelines, broker/agent agreements and loan application forms for each residential loan product that represents an appreciable volume of, or displays noticeable growth in, the institution's residential lending.
- Review also any available data regarding the geographic distribution of the institution's loan originations with respect to the race and national origin percentages of the census tracts within its assessment area or, if different, its residential loan product lending area(s).
- Conduct interviews of loan officers and other employees or agents in the residential lending process concerning adherence to and understanding of the above policies and guidelines as well as any relevant operating practices.
- In the course of conducting the foregoing inquiries, look for the following risk factors (factors are numbered alphanumerically to coincide with the type of factor, e.g., "O" for "overt"; "P" for "pricing", etc.).

NOTE: For risk factors below that are marked with an asterisk (\*), examiners need not attempt to calculate the indicated ratios for racial or national origin characteristics when the institution is not a HMDA reporter. However, consideration should be given in such cases to whether or not such calculations should be made based on gender or racial-ethnic surrogates.

##### **Overt** indicators of discrimination such as:

- O1. Including explicit prohibited basis identifiers in the institution's written or oral policies and procedures (underwriting criteria, pricing standards, etc.)
- O2. Collecting information, conducting inquiries or imposing conditions contrary to express requirements of Regulation B
- O3. Including variables in a credit scoring system that constitute a basis or factor prohibited by Regulation B or, for residential loan scoring systems, the FhAct. (If a credit scoring system scores age, refer to *Part E* of the *Considering Automated Underwriting and Credit Scoring* section of the Appendix.)
- O4. Statements made by the institution's officers, employees or agents which constitute an express or implicit indication that one or

more such persons have engaged or do engage in discrimination on a prohibited basis in any aspect of a credit transaction

- O5. Employee or institutional statements that evidence attitudes based on prohibited basis prejudices or stereotypes.

##### *Indicators of potential disparate treatment in Underwriting* such as:

- U1. \*Substantial disparities among the approval/denial rates for applicants by monitored prohibited basis characteristic (especially within income categories)
- U2. \*Substantial disparities among the application processing times for applicants by monitored prohibited basis characteristic (especially within denial reason groups)
- U3. \*Substantially higher proportion of withdrawn/incomplete applications from prohibited basis group applicants than from other applicants
- U4. Vague or unduly subjective underwriting criteria
- U5. Lack of clear guidance on making exceptions to underwriting criteria, including credit scoring overrides
- U6. Lack of clear loan file documentation regarding reasons for any exceptions to standard underwriting criteria, including credit scoring overrides
- U7. Relatively high percentages of either exceptions to underwriting criteria or overrides of credit score cutoffs
- U8. Loan officer or broker compensation based on loan volume (especially loans approved per period of time)
- U9. Consumer complaints alleging discrimination in loan processing or in approving/denying residential loans.

##### *Indicators of potential disparate treatment in Pricing* (interest rates, fees, or points) such as:

- P1. Financial incentives for loan officers or brokers to charge higher prices (including interest rate, fees and points). Special attention should be given to situations where financial incentives are accompanied by broad pricing discretion (as in P2), such as through the use of overages or yield spread premiums.
- P2. Presence of broad discretion in loan pricing (including interest rate, fees and points), such as through overages, underages or yield spread premiums. Such discretion may be present even when institutions provide

rate sheets and fees schedules, if loan officers or brokers are permitted to deviate from those rates and fees without clear and objective criteria.

- P3. Use of risk-based pricing that is not based on objective criteria or applied consistently
- P4. \*Substantial disparities among prices being quoted or charged to applicants who differ as to their monitored prohibited basis characteristics
- P5. Consumer complaints alleging discrimination in residential loan pricing.
- P6. \*In mortgage pricing, disparities in the incidence or rate spreads<sup>1</sup> of higher-priced lending by prohibited basis characteristics as reported in the HMDA data.
- P7. \*A loan program that contains only borrowers from a prohibited basis group, or has significant differences in the percentages of prohibited basis groups, especially in the absence of a Special Purpose Credit Program under ECOA.

*Indicators of potential **disparate treatment by Steering** such as:*

- S1. Lack of clear, objective and consistently implemented standards for (i) referring applicants to subsidiaries, affiliates, or lending channels within the institution (ii) classifying applicants as “prime” or “sub-prime” borrowers, or (iii) deciding what kinds of alternative loan products should be offered or recommended to applicants (product placement).
- S2. Financial incentives for loan officers or brokers to place applicants in nontraditional products (i.e., negative amortization, “interest only”, “payment option” adjustable rate mortgages) or higher cost products.
- S3. For an institution that offers different products based on credit risk levels, any significant differences in percentages of prohibited basis groups in each of the alternative loan product categories.
- S4. \*Significant differences in the percentage of prohibited basis applicants in loan products or products with specific features relative to control group applicants. Special attention should be given to products and features that have potentially negative consequences for applicants (i.e., non-traditional mortgages, prepayment penalties, lack of escrow requirements, or credit life insurance)
- S5. \*For an institution that has one or more

sub-prime mortgage subsidiaries or affiliates, any significant differences, by loan product, in the percentage of prohibited basis applicants of the institution compared to the percentage of prohibited basis applicants of the subsidiary(ies) or affiliate(s).

- S6. \*For an institution that has one or more lending channels that originate the same loan product, any significant differences in the percentage of prohibited basis applicants in one of the lending channels compared to the percentage of prohibited basis applicants of the other lending channel.
- S7. Consumer complaints alleging discrimination in residential loan pricing or product placement.
- S8. \*For an institution with sub-prime mortgage subsidiaries, a concentration of those subsidiaries’ branches in minority areas relative to its other branches.

*Indicators of potential **discriminatory Redlining** such as:*

- R1. \*Significant differences, as revealed in HMDA data, in the number of applications received, withdrawn, approved not accepted, and closed for incompleteness or loans originated in those areas in the institution’s market that have relatively high concentrations of minority group residents compared with areas with relatively low concentrations of minority residents.
- R2. \*Significant differences between approval/denial rates for all applicants (minority and non-minority) in areas with relatively high concentrations of minority group residents compared with areas with relatively low concentrations of minority residents.
- R3. \*Significant differences between denial rates based on insufficient collateral for applicants from areas with relatively high concentrations of minority residents and those areas with relatively low concentrations of minority residents.
- R4. \*Significant differences in the number of originations of higher-priced loans or loans with potentially negative consequences for borrowers, (i.e., non-traditional mortgages, prepayment penalties, lack of escrow requirements) in areas with relatively high concentrations of minority residents compared with areas with relatively low concentrations of minority residents.
- R5. Other patterns of lending identified during the most recent CRA examination that differ by the concentration of minority residents.

1. Regulation C, Section 203.4(a)(12).

- R6. Explicit demarcation of credit product markets that excludes MSAs, political subdivisions, census tracts, or other geographic areas within the institution's lending market or CRA assessment areas and having relatively high concentrations of minority residents.
- R7. Difference in services available or hours of operation at branch offices located in areas with concentrations of minority residents when compared to branch offices located in areas with concentrations of non-minority residents.
- R8. Policies on receipt and processing of applications, pricing, conditions, or appraisals and valuation, or on any other aspect of providing residential credit that vary between areas with relatively high concentrations of minority residents and those areas with relatively low concentrations of minority residents.
- R9. The institution's CRA assessment area appears to have been drawn to exclude areas with relatively high concentrations of minority residents.
- R10. Employee statements that reflect an aversion to doing business in areas with relatively high concentrations of minority residents.
- R11. Complaints or other allegations by consumers or community representatives that the institution excludes or restricts access to credit for areas with relatively high concentrations of minority residents. Examiners should review complaints against the institution filed either with their agency or the institution; the CRA public comment file; community contact forms; and the responses to questions about redlining, discrimination, and discouragement of applications, and about meeting the needs of racial or national origin minorities, asked as part of obtaining local perspectives on the performance of financial institutions during prior CRA examinations.
- R12. An institution that has most of its branches in predominantly non-minority neighborhoods at the same time that the institution's sub-prime mortgage subsidiary has branches which are located primarily in predominantly minority neighborhoods.
- M2. Advertising only in media serving non-minority areas of the market.
- M3. Marketing through brokers or other agents that the institution knows (or has reason to know) would serve only one racial or ethnic group in the market.
- M4. Use of marketing programs or procedures for residential loan products that exclude one or more regions or geographies within the institutions assessment or marketing area that have significantly higher percentages of minority group residents than does the remainder of the assessment or marketing area.
- M5. Using mailing or other distribution lists or other marketing techniques for pre-screened or other offerings of residential loan products that:
  - Explicitly exclude groups of prospective borrowers on a prohibited basis; or
  - Exclude geographies (e.g., census tracts, ZIP codes, etc.) within the institution's marketing area that have significantly higher percentages of minority group residents than does the remainder of the marketing area.
- M6. \*Proportion of prohibited basis applicants is significantly lower than that group's representation in the total population of the market area.
- M7. Consumer complaints alleging discrimination in advertising or marketing loans.

### Step Five: Organize and Focus Residential Risk Analysis

Review the risk factors identified in Step 4 and, for each loan product that displays risk factors, articulate the possible discriminatory effects encountered and organize the examination of those loan products in accordance with the following guidance. For complex issues regarding these factors, consult with agency supervisory staff.

- Where overt evidence of discrimination, as described in factors O1–O5, has been found in connection with a product, document those findings as described in Part III, B, besides completing the remainder of the planned examination analysis.
- Where any of the risk factors U1–U9 are present, consider conducting an underwriting comparative file analysis as described in Part III, C.
- Where any of the risk factors P1–P7 are present, consider conducting a pricing comparative file analysis as described in Part III, D.

#### *Indicators of potential **disparate treatment in Marketing** of residential products, such as:*

- M1. Advertising patterns or practices that a reasonable person would believe indicate prohibited basis customers are less desirable.

- Where any of the risk factors S1–S8 are present, consider conducting a steering analysis as described in Part III, E.
- Where any of the risk factors R1–R12 are present, consider conducting an analysis for redlining as described in Part III, G.
- Where any of the risk factors M1–M7 are present, consider conducting a marketing analysis as described in Part III, H.
- Where an institution uses age in any credit scoring system, consider conducting an examination analysis of that credit scoring system's compliance with the requirements of Regulation B as described in Part III, I.

### Step Six: Identify Consumer Lending Discrimination Risk Factors

For any consumer loan products selected in Step One for risk analysis, examiners should conduct a risk factor review similar to that conducted for residential lending products in Steps Three through Five, above. Examiners should consult with agency supervisory staff regarding the potential use of surrogates to identify possible prohibited basis group individuals.

NOTE: The term surrogate in this context refers to any factor related to a loan applicant that potentially identifies that applicant's race, color or other prohibited basis characteristic in instances where no direct evidence of that characteristic is available. Thus, in consumer lending, where monitoring data is generally unavailable, a Hispanic or Asian surname could constitute a surrogate for an applicant's race or national origin because the examiner can assume that the institution (which can rebut the presumption) perceived the person to be Hispanic or Asian. Similarly, an applicant's given name could serve as a surrogate for his or her gender. A surrogate for a prohibited basis group characteristic may be used to set up a comparative analysis with control group applicants or borrowers.

Examiners should then follow the rules in Steps Three through Five, above and identify the possible discriminatory patterns encountered and consider examining those products determined to have sufficient risk of discriminatory conduct.

### Step Seven: Identify Commercial Lending Discrimination Risk Factors

Where an institution does a substantial amount of

lending in the commercial lending market, most notably small business lending and the product has not recently been examined or the underwriting standards have changed since the last examination of the product, the examiner should consider conducting a risk factor review similar to that performed for residential lending products, as feasible, given the limited information available. Such an analysis should generally be limited to determining risk potential based on risk factors U4–U8; P1–P3; R5–R7; and M1–M3.

If the institution makes commercial loans insured by the Small Business Administration (SBA), determine from agency supervisory staff whether SBA loan data (which codes race and other factors) are available for the institution and evaluate those data pursuant to instructions accompanying them.

For large institutions reporting small business loans for CRA purposes and where the institution also voluntarily geocodes loan denials, look for material discrepancies in ratios of approval-to-denial rates for applications in areas with high concentrations of minority residents compared to areas with concentrations of non-minority residents.

Articulate the possible discriminatory patterns identified and consider further examining those products determined to have sufficient risk of discriminatory conduct in accordance with the procedures for commercial lending described in Part III, F.

### Step Eight: Complete the Scoping Process

To complete the scoping process, the examiner should review the results of the preceding steps and select those focal points that warrant examination, based on the relative risk levels identified above. In order to remain within the agency's resource allowances, the examiner may need to choose a smaller number of focal points from among all those selected on the basis of risk. In such instances, set the scope by first, prioritizing focal points on the basis of (i) high number and/or relative severity of risk factors; (ii) high data quality and other factors affecting the likelihood of obtaining reliable examination results; (iii) high loan volume and the likelihood of widespread risk to applicants and borrowers; and (iv) low quality of any compliance program and, second, selecting for examination review as many focal points as resources permit.

Where the judgment process among competing focal points is a close call, information learned in

the phase of conducting the compliance management review can be used to further refine the examiner's choices.

## PART II. COMPLIANCE MANAGEMENT REVIEW

The Compliance Management Review enables the examination team to determine:

- The intensity of the current examination based on an evaluation of the compliance management measures employed by an institution
- The reliability of the institution's practices and procedures for ensuring continued fair lending compliance.

Generally, the review should focus on

- Determining whether the policies and procedures of the institution enable management to prevent, or to identify and self-correct, illegal disparate treatment in the transactions that relate to the products and issues identified for further analysis under Part I of these procedures
- Obtaining a thorough understanding of the manner by which management addresses its fair lending responsibilities with respect to (a) the institution's lending practices and standards, (b) training and other application-processing aids, (c) guidance to employees or agents in dealing with customers, and (d) its marketing or other promotion of products and services.

To conduct this review, examiners should consider institutional records and interviews with appropriate management personnel in the lending, compliance, audit, and legal functions. The examiner should also refer to the *Compliance Management Analysis Checklist* contained in the Appendix to evaluate the strength of the compliance programs in terms of their capacity to prevent, or to identify and self-correct, fair lending violations in connection with the products or issues selected for analysis. Based on this evaluation

- Set the intensity of the transaction analysis by minimizing sample sizes within the guidelines established in Part III and the *Fair Lending Sample Size Tables* in the Appendix, to the extent warranted by the strength and thoroughness of the compliance programs applicable to those focal points selected for examination
- Identify any compliance program or system deficiencies that merit correction or improvement and present these to management in accordance with Part IV of these procedures.

Where an institution performs a self-evaluation or has voluntarily disclosed the report or results of a self-test of any product or issue that is within the

scope of the examination and has been selected for analysis pursuant to Part I of these procedures, examiners may streamline the examination, consistent with agency guidance, provided the self-test or self-evaluation meets the requirements set forth in *Using Self-Tests and Self-Evaluations to Streamline the Examination* located in the Appendix.

## PART III. EXAMINATION PROCEDURES

Once the scope and intensity of the examination have been determined, assess the institution's fair lending performance by applying the appropriate procedures that follow to each of the examination focal points already selected.

### A. Verify Accuracy of Data

Prior to any analysis and preferably before the scoping process, examiners should assess the accuracy of the data being reviewed. Data verifications should follow specific protocols (sampling, size, etc.) intended to ensure the validity of the review. For example, where an institution's LAR data is relied upon, examiners should generally validate the accuracy of the institution's submitted data by selecting a sample of LAR entries and verifying that the information noted on the LAR was reported according to instructions by comparing information contained in the loan file for each sampled loan. If the LAR data are inconsistent with the information contained in the loan files, depending on the nature of the errors, examiners may not be able to proceed with a fair lending analysis until the LAR data have been corrected by the institution. In cases where inaccuracies impede the examination, examiners should direct the institution to take action to ensure data integrity (data scrubbing, monitoring, training, etc.).

Note: While the procedures refer to the use of HMDA data, other data sources should be considered, especially in the case of non-HMDA reporters or institutions that originate loans but are not required to report them on a LAR.

### B. Documenting Overt Evidence of Disparate Treatment

Where the scoping process or any other source identifies overt evidence of disparate treatment, the examiner should assess the nature of the policy or statement and the extent of its impact on affected applicants by conducting the following analysis

*Step 1. Where the indicator(s) of overt discrimination are found in or based on a written policy for example, a credit scorecard) or communication, determine and document.*

- a. The precise language of the apparently discriminatory policy or communication and the nature

of the fair lending concerns that it raises

- b. The institution's stated purpose in adopting the policy or communication and the identity of the person on whose authority it was issued or adopted
- c. How and when the policy or communication was put into effect
- d. How widely the policy or communication was applied
- e. Whether and to what extent applicants were adversely affected by the policy or communication.

*Step 2. Where any indicator of overt discrimination was an oral statement or unwritten practice, determine and document:*

- a. The precise nature of both the statement or practice and of the fair lending concerns that they raise
- b. The identity of the persons making the statement or applying the practice and their descriptions of the reasons for it and the persons authorizing or directing the use of the statement or practice
- c. How and when the statement or practice was disseminated or put into effect
- d. How widely the statement or practice was disseminated or applied
- e. Whether and to what extent applicants were adversely affected by the statement or practice.

Assemble findings and supporting documentation for presentation to management in connection with Part IV of these procedures.

## C. Transactional Underwriting Analysis—Residential and Consumer Loans

*Step 1: Set Sample Size*

- a. For each focal point selected for this analysis, two samples will be utilized: (i) prohibited basis group denials and (ii) control group approvals, both identified either directly from monitoring information in the case of residential loan applications or through the use of application data or surrogates in the case of consumer applications.
- b. Refer to *Fair Lending Sample Size Tables, Table A* in the Appendix and determine the size of the initial sample for each focal point, based on the number of prohibited basis group denials and the number of control group approvals by the institution during the twelve month (or calendar year) period of lending activity preceding the examination. In the event

that the number of denials and/or approvals acted on during the preceding 12 month period substantially exceeds the maximum sample size shown in Table A, reduce the time period from which that sample is selected to a shorter period. (In doing so, make every effort to select a period in which the institution's underwriting standards are most representative of those in effect during the full 12 month period preceding the examination.)

- c. If the number of prohibited basis group denials or control group approvals for a given focal point that were acted upon during the 12 month period referenced in 1.b., above, do not meet the minimum standards set forth in the Sample Size Table, examiners need not attempt a transactional analysis for that focal point. Where other risk factors favor analyzing such a focal point, consult with agency supervisory staff on possible alternative methods of judgmental comparative analysis.
- d. If agency policy calls for a different approach to sampling (e.g., a form of statistical analysis, a mathematical formula, or an automated tool) for a limited class of institutions, examiners should follow that approach.

*Step 2. Determine Sample Composition.*

- a. To the extent the institution maintains records of loan outcomes resulting from exceptions to its credit underwriting standards or other policies (e.g., overrides to credit score cutoffs), request such records for both approvals and denials, sorted by loan product and branch or decision center, if the institution can do so. Include in the initial sample for each focal point all exceptions or overrides applicable to that focal point.
- b. Using HMDA/LAR data or, for consumer loans, comparable loan register data to the extent available, choose approved and denied applications based on selection criteria that will maximize the likelihood of finding marginal approved and denied applicants, as discussed below.
- c. To the extent that the above factors are inapplicable or other selection criteria are unavailable or do not facilitate selection of the entire sample size of files, complete the initial sample selection by making random file selections from the appropriate sample categories in the Sample Size Table.

*Step 3: Compare Approved and Denied Applications*

*Overview:* Although a creditor's written policies and procedures may appear to be nondiscriminatory, lending personnel may interpret or apply policies in a discriminatory manner. In order to detect any



disparate treatment among applicants, the examiner should first eliminate all but “marginal transactions” (see 3.b. below) from each selected focal point sample. Then, a detailed profile of each marginal applicant’s qualifications, the level of assistance received during the application process, the reasons for denial, the loan terms, and other information should be recorded on an Applicant Profile Spreadsheet. Once profiled, the examiner can compare the target and control groups for evidence that similarly qualified applicants have been treated differently as to either the institution’s credit decision or the quality of assistance provided.

a. *Create Applicant Profile Spreadsheet*

Based upon the institution’s written and/or articulated credit standards and loan policies, identify categories of data that should be recorded for each applicant and provide a field for each of these categories on a worksheet or computerized spreadsheet. Certain data (income, loan amount, debt, etc.) should always be included in the spreadsheet, while the other data selected will be tailored for each loan product and institution based on applicable underwriting criteria and such issues as branch location and underwriter. Where credit bureau scores and/or application scores are an element of the institution’s underwriting criteria (or where such information is regularly recorded in loan files, whether expressly used or not), include a data field for this information in the spread sheet.

In order to facilitate comparisons of the quality of assistance provided to target and control group applicants, respectively, every work sheet should provide a “comments” block appropriately labeled as the site for recording observations from the file or interviews regarding how an applicant was, or was not, assisted in overcoming credit deficiencies or otherwise qualifying for approval.

b. *Complete Applicant Profiles*

From the application files sample for each focal point, complete applicant profiles for selected denied and approved applications as follows:

- A principal goal is to identify cases where similarly qualified prohibited basis and control group applicants had different credit outcomes, because the agencies have found that discrimination, including differences in granting assistance during the approval process, is more likely to occur with respect to applicants who are *not* either clearly qualified or unqualified, i.e., “marginal” applicants. The examiner-in-charge should, during the following steps, judgmentally select from the initial sample only those denied and approved

applications which constitute marginal transactions. (See Appendix on *Identifying Marginal Transactions* for guidance)

- If few marginal control group applicants are identified from the initial sample, review additional files of approved control group applicants. This will either increase the number of marginal approvals or confirm that marginal approvals are so infrequent that the marginal denials are unlikely to involve disparate treatment.
- The judgmental selection of both marginal-denied and marginal-approved applicant loan files should be done together, in a “back and forth” manner, to facilitate close matches and a more consistent definition of “marginal” between these two types of loan files.
- Once the marginal files have been identified, the data elements called for on the profile spreadsheet are extracted or noted and entered.
- While conducting the preceding step, the examiner should simultaneously look for and document on the spreadsheet any evidence found in marginal files regarding the following:
  - the extent of any assistance, including both affirmative aid and waivers or partial waivers of credit policy provisions or requirements, that appears to have been provided to marginal-approved control group applicants which enabled them to overcome one or more credit deficiencies, such as excessive debt-to-income ratios
  - the extent to which marginal-denied target group applicants with similar deficiencies were, or were not, provided similar affirmative aid, waivers or other forms of assistance.

c. *Review and Compare Profiles*

- For each focal point, review all marginal profiles to determine if the underwriter followed institution lending policies in denying applications and whether the reason(s) for denial were supported by facts documented in the loan file and properly disclosed to the applicant pursuant to Regulation B. If any (a) unexplained deviations from credit standards, (b) inaccurate reasons for denial or (c) incorrect disclosures are noted, (whether in a judgmental underwriting system, a scored system or a mixed system) the examiner should obtain an explanation from the underwriter and document the response on an appropriate workpaper.

NOTE: In constructing the applicant profiles to be compared, examiners must adjust the

facts compared so that assistance, waivers, or acts of discretion are treated consistently between applicants. For example, if a control group applicant's DTI ratio was lowered to 42% because the institution decided to include short-term overtime income, and a prohibited basis group applicant who was denied due to "insufficient income" would have had his ratio drop from 46% to 41% if his short-term overtime income had been considered, then the examiners should consider 41%, not 46%, in determining the benchmark.

- For each reason for denial identified within the target group, rank the denied prohibited basis applicants, beginning with the applicant whose qualification(s) related to that reason for denial were least deficient. (The top-ranked denied applicant in each such ranking will be referred to below as the "benchmark" applicant.)
- Compare each marginal control group approval to the benchmark applicant in each reason-for-denial ranking developed in step (b), above. If there are no approvals who are equally or less qualified, then there are no instances of disparate treatment for the institution to account for. For all such approvals that appear no better qualified than the denied benchmark applicant
  - identify the approved loan on the worksheet or spreadsheet as an "overlap approval", and
  - compare that overlap approval with other marginal prohibited basis denials in the ranking to determine whether additional overlaps exist. If so, identify all overlapping approvals and denials as above.
- Where the focal point involves use of a credit scoring system, the analysis for disparate treatment is similar to the procedures set forth in (c) above, and should focus primarily on overrides of the scoring system itself. For guidance on this type of analysis, refer to *Considering Automated Underwriting and Credit Scoring, Part C* in the Appendix.

*Step 4. If there is some evidence of violations in the underwriting process but not enough to clearly establish the existence of a pattern or practice, the examiner should expand the sample as necessary to determine whether a pattern or practice does or does not exist.*

*Step 5. Discuss all findings resulting from the above comparisons with management and document both the findings and all conversations on an*

*appropriate worksheet.*

## D. Analyzing Potential Disparities in Pricing and Other Terms and Conditions

Depending on the intensity of the examination and the size of the borrower population to be reviewed, the analysis of decisions on pricing and other terms and conditions may involve a comparative file review, statistical analysis, a combination of the two, or other specialized technique used by an agency. Each examination process assesses an institution's credit-decision standards and whether decisions on pricing and other terms and conditions are applied to borrowers without regard to a prohibited basis.

The procedures below encompass the examination steps for a comparative file review. Examiners should consult their own agency's procedures for detailed guidance where appropriate. For example, when file reviews are undertaken in conjunction with statistical analysis, the guidance on specific sample sizes referenced below may not apply.

### *Step 1: Determine Sample Selection*

Examiners may review data in its entirety or restrict their analysis to a sample depending on the examination approach used and the quality of the institution's compliance management system. The *Fair Lending Sample Size Tables* in the Appendix provide general guidance about appropriate sample sizes. Generally, the sample size should be based on the number of prohibited basis group and control group originations for each focal point selected during the 12 months preceding the examination and the outcome of the compliance management system analysis conducted in Part II. When possible, examiners should request specific loan files in advance and request that the institution have them available for review at the start of the examination.

### *Step 2: Determine Sample Composition and Create Applicant Profiles*

Examiners should tailor their sample and subsequent analysis to the specific factors that the institution considers when determining its pricing, terms, and conditions. For example, while decisions on pricing, and other terms and conditions are part of an institution's underwriting process, general underwriting criteria should not be used in the analysis if they are not relevant to the term or condition to be reviewed. Additionally, consideration should be limited to factors which examiners

determine to be legitimate.

- a. While the period for review should be 12-months, prohibited basis group and control group borrowers should be grouped and reviewed around a range of dates during which the institution's practices for the term or condition being reviewed were the same. Generally, examiners should use the loan origination date or the loan application date.
- b. Identify data to be analyzed for each focal point to be reviewed and record this information for each borrower on a spreadsheet to ensure a valid comparison regarding terms and conditions. For example, in certain cases, an institution may offer slightly differentiated products with significant pricing implications to borrowers. In these cases, it may be appropriate to group these procedures together for the purposes of evaluation.

*Step 3: Review Terms and Conditions; Compare with Borrower Outcomes*

- a. Review all loan terms and conditions (rates, points, fees, maturity variations, LTVs, collateral requirements, etc.) with special attention to those which are left, in whole or in part, to the discretion of loan officers or underwriters. For each such term or condition, identify (a) any prohibited basis group borrowers in the sample who appear to have been treated unfavorably with respect to that term or condition and (b) any control group borrowers who appear to have been treated favorably with respect to that term or condition. The examiner's analysis should be thoroughly documented in the workpapers.
- b. Identify from the sample universe any control group borrowers who appear to have been treated more favorably than one or more of the above-identified prohibited basis group borrowers and who have pricing or creditworthiness factors (under the institution's standards) that are equal to or less favorable than the prohibited basis group borrowers.
- c. Obtain explanations from the appropriate loan officer or other employee for any differences that exist and reanalyze the sample for evidence of discrimination.
- d. If there is some evidence of violations in the imposition of terms and conditions but not enough to clearly establish the existence of a pattern or practice, the examiner should expand the sample as necessary to determine whether a pattern or practice does or does not exist.
- e. Discuss differences in comparable loans with the institution's management and document all conversations on an appropriate worksheet. For

additional guidance on evaluating management's responses, refer to *Part A, 1–5, Evaluating Responses to Evidence of Disparate Treatment* in the Appendix.

## E. Steering Analysis

An institution that offers a variety of lending products or product features, either through one channel or through multiple channels, may benefit consumers by offering greater choices and meeting the diverse needs of applicants. Greater product offerings and multiple channels, however, may also create a fair lending risk that applicants will be illegally steered to certain choices based on prohibited characteristics.

Several examples illustrate potential fair lending risk:

- An institution that offers different lending products based on credit risk levels may present opportunities for loan officers or brokers to illegally steer applicants to the higher-risk products
- An institution that offers nontraditional loan products or loan products with potentially onerous terms (such as prepayment penalties) may present opportunities for loan officers or brokers to illegally steer applicants to certain products or features
- An institution that offers prime or sub-prime products through different channels may present opportunities for applicants to be illegally steered to the sub-prime channel

The distinction between guiding consumers toward a specific product or feature and illegal steering centers on whether the institution did so on a prohibited basis, rather than based on an applicant's needs or other legitimate factors. It is not necessary to demonstrate financial harm to a group that has been "steered." It is enough to demonstrate that action was taken on a prohibited basis regardless of the ultimate financial outcome. If the scoping analysis reveals the presence of one or more risk factors S1 through S8 for any selected focal point, consult with agency supervisory staff about conducting a steering analysis as described below.

*Step 1. Clarify what options are available to applicants.*

Through interviews with appropriate personnel of the institution and review of policy manuals, procedure guidelines and other directives, obtain and verify the following information for each product-alternative product pairing or grouping identified above:

- a. All underwriting criteria for the product or

feature and their alternatives that are offered by the institution or by a subsidiary or affiliate. Examples of products may include stated income, negative amortization and options ARMs. Examples of terms and features include prepayment penalties and escrow requirements. The distinction between a product, term, and feature may vary institution to institution. For example, some institutions may consider “stated income” a feature, while others may consider that a distinct product.

- b. Pricing or other costs applicable to the product and the alternative product(s), including interest rates, points, and all fees.

*Step 2: Document the policies, conditions or criteria that have been adopted by the institution for determining how referrals are to be made and choices presented to applicants.*

- a. Obtain not only information regarding the product or feature offered by the institution and alternatives offered by subsidiaries/affiliates, but also information on alternatives offered solely by the institution itself.
- b. Obtain any information regarding a subsidiary of the institution directly from that entity, but seek information regarding an affiliate or holding company subsidiary only from the institution itself.
- c. Obtain all appropriate documentation and provide a written summary of all discussions with loan personnel and managers.
- d. Obtain documentation and/or employee estimates as to the volume of referrals made from or to the institution, for each product, during a relevant time period.
- e. Resolve to the extent possible any discrepancies between information found in the institution’s documents and information obtained in discussions with loan personnel and managers by conducting appropriate follow-up interviews.
- f. Identify any policies and procedures established by the institution and/or the subsidiary or affiliate for (i) referring a person who applies to the institution, but does not meet its criteria, to another internal lending channel, subsidiary or affiliate; (ii) offering one or more alternatives to a person who applies to the institution for a specific product or feature, but does not meet its criteria; or (iii) referring a person who applies to a subsidiary or affiliate for its product, but who appears qualified for a loan from the institution, to the institution; or referring a person who applies through one internal lending channel for a product, but who appears to be qualified for a loan through another lending channel to that particular lending channel.

- g. Determine whether loan personnel are encouraged, through financial incentives or otherwise, to make referrals, either from the institution to a subsidiary/affiliate or vice versa. Similarly, determine whether the institution provides financial incentives related to products and features.

*Step 3. Determine how referral decisions are made and documented within the institution.*

Determine how a referral is made to another internal lending channel, subsidiary, or affiliate. Determine the reason for referral and how it is documented.

*Step 4. Determine to what extent individual loan personnel are able to exercise personal discretion in deciding what loan products or other credit alternatives will be made available to a given applicant.*

*Step 5. Determine whether the institution’s stated policies, conditions or criteria in fact are adhered to by individual decision makers. If not, does it appear that different policies or practices are actually in effect?*

Enter data from the prohibited basis group sample on the spread sheets and determine whether the institution is, in fact, applying its criteria as stated. For example, if one announced criterion for receiving a “more favorable” prime mortgage loan was a back end debt ratio of no more than 38%, review the spread sheets to determine whether that criteria was adhered to. If the institution’s actual treatment of prohibited basis group applicants appears to differ from its stated criteria, document such differences for subsequent discussion with management.

*Step 6. To the extent that individual loan personnel have any discretion in deciding what products and features to offer applicants, conduct a comparative analysis to determine whether that discretion has been exercised in a nondiscriminatory manner.*

Compare the institution’s or subsidiary/affiliate’s treatment of control group and prohibited basis group applicants by adapting the “benchmark” and “overlap” technique discussed in Part III, Section C. of these procedures. For purposes of this Steering Analysis, that technique should be conducted as follows:

- a. For each focal point to be analyzed, select a sample of prohibited basis group applicants who received “less favorable” treatment (e.g., referral to a finance company or a subprime mortgage subsidiary or counteroffers of less favorable product alternatives).

NOTE: In selecting the sample, follow the guidance of *Fair Lending Sample Size Tables, Table B* in the Appendix and select “marginal

applicants” as instructed in Part III, Section C, above.

- b. Prepare a spread sheet for the sample which contains data entry categories for those underwriting and/or referral criteria that the institution identified in Step 1.b as used in reaching underwriting and referral decisions between the pairs of products.
- c. Review the “less favorably” treated prohibited basis group sample and rank this sample from least qualified to most qualified.
- d. From the sample, identify the best qualified prohibited basis group applicant, based on the criteria identified for the control group, above. This applicant will be the “benchmark” applicant. Rank order the remaining applicants from best to least qualified.
- e. Select a sample of control group applicants. Identify those who were treated “more favorably” with respect to the same product-alternative product pair as the prohibited basis group. (Again refer to the Sample Size Table B and marginal applicant processes noted above in selecting the sample.)
- f. Compare the qualifications of the benchmark applicant with those of the control group applicants, beginning with the least qualified member of that sample. Any control group applicant who appears less qualified than the benchmark applicant should be identified on the spreadsheet as a “control group overlap”.
- g. Compare all control group overlaps with other, less qualified prohibited basis group applicants to determine whether additional overlaps exist
- h. Document all overlaps as possible disparities in treatment. Discuss all overlaps and related findings (e.g., any differences between stated and actual underwriting and/or referral criteria) with management, documenting all such conversations.

*Step 7. Examiners should consult with their agency’s supervisory staff if they see a need to contact control group or prohibited basis group applicants to substantiate the steering analysis.*

## F. Transactional Underwriting Analysis—Commercial Loans

*Overview.* Unlike consumer credit, where loan products and prices are generally homogenous and underwriting involves the evaluation of a limited number of credit variables, commercial loans are generally unique and underwriting methods and loan pricing may vary depending on a large number of credit variables. The additional credit analysis that is involved in underwriting

commercial credit products will entail additional complexity in the sampling and discrimination analysis process. Although ECOA prohibits discrimination in all commercial credit activities of a covered institution, the agencies recognize that small businesses (sole proprietorships, partnerships, and small, closely-held corporations) may have less experience in borrowing. Small businesses may have fewer borrowing options, which may make them more vulnerable to discrimination. Therefore, in implementing these procedures, examinations should generally be focused on small business credit (commercial applicants that had gross revenues of \$1,000,000 or less in the preceding fiscal year), absent some evidence that a focus on other commercial products would be more appropriate.

### *Step 1: Understand Commercial Loan Policies*

For the commercial product line selected for analysis, the examiner should first review credit policy guidelines and interview appropriate commercial loan managers and officers to obtain written and articulated standards used by the institution in evaluating commercial loan applications.

NOTE: Examiners should consult their own agencies for guidance on when a comparative analysis or statistical analysis is appropriate, and follow their agencies procedures for conducting such a review/analysis.

### *Step 2: Conduct Comparative File Review*

- a. Select all (or a maximum of ten) denied applications that were acted on during the three month period prior to the examination. To the extent feasible, include denied applications from businesses that are (i) located in minority and/or integrated geographies or (ii) appear to be owned by women or minority group members, based on the names of the principals shown on applications or related documents. (In the case of institutions that do a significant volume of commercial lending, consider reviewing more than ten applications.)
- b. For each of the denied commercial applications selected, record specific information from loan files and through interviews with the appropriate loan officer(s), about the principal owners, the purpose of the loan, and the specific, pertinent financial information about the commercial enterprise (including type of business—retail, manufacturing, service, etc.), that was used by the institution to evaluate the credit request. Maintenance or use of data that identifies prohibited basis characteristics of those involved with the business (either in approved or denied loan applications) should be evaluated as a potential violation of Regulation B.

- c. Select ten approved loans that appear to be similar with regard to business type, purpose of loan, loan amount, loan terms, and type of collateral, as the denied loans sampled. For example, if the denied loan sample includes applications for lines of credit to cover inventory purchases for retail businesses, the examiner should select approved applications for lines of credit from retail businesses.
- d. For each approved commercial loan application selected, obtain and record information parallel to that obtained for denied applications.
- e. The examiner should first compare the credit criteria considered in the credit process for each of the approved and denied applications to established underwriting standards, rather than comparing files directly.
- f. The examiner should identify any deviations from credit standards for both approved and denied credit requests, and differences in loan terms granted for approved credit requests.
- g. The examiner should discuss each instance where deviations from credit standards and terms were noted, but were not explained in the file, with the commercial credit underwriter. Each discussion should be documented.

#### *Step 3: Conduct Targeted Sampling*

- a. If deviations from credit standards or pricing are not sufficiently explained by other factors either documented in the credit file or the commercial underwriter was not able to provide a reasonable explanation, the examiner should determine if deviations were detrimental to any protected classes of applicants.
- b. The examiner should consider employing the same techniques for determining race and gender characteristics of commercial applicants as those outlined in the consumer loan sampling procedures.
- c. If it is determined that there are members of one or more prohibited basis groups among commercial credit requests that were not underwritten according to established standards or received less favorable terms, the examiner should select additional commercial loans, where applicants are members of the same prohibited basis group and select similarly situated control group credit requests in order to determine whether there is a pattern or practice of discrimination. These additional files should be selected based on the specific applicant circumstance(s) that appeared to have been viewed differently by lending personnel on a prohibited basis.
- d. If there are not enough similarly situated applicants for comparison in the original sample

period to draw a reasonable conclusion, the examiner should expand the sample period. The expanded sample period should generally not go beyond the date of the prior examination.

#### *Sampling Guidelines*

- a. Generally, the task of selecting an appropriate expanded sample of prohibited basis and control group applications for commercial loans will require examiner judgment. The examiner should select a sample that is large enough to be able to draw a reasonable conclusion.
- b. The examiner should first select from the applications that were acted on during the initial sample period, but were not included in the initial sample, and select applications from prior time periods as necessary.
- c. The expanded sample should include both approved and denied, prohibited basis and control group applications, where similar credit was requested by similar enterprises for similar purposes.

## **G. Analysis of Potential Discriminatory “Redlining”**

*Overview:* For purposes of this analysis, traditional “redlining” is a form of illegal disparate treatment in which an institution provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located. Redlining may also include “reverse redlining,” the practice of targeting certain borrowers or areas with less advantageous products or services based on prohibited characteristics.

The redlining analysis may be applied to determine whether, on a prohibited basis:

- an institution fails or refuses to extend credit in certain areas;
- an institution targets certain borrowers or certain areas with less advantageous products
- an institution makes loans in such an area but at a restricted level or upon less-favorable terms or conditions as compared to contrasting areas; or
- an institution omits or excludes such an area from efforts to market residential loans or solicit customers for residential credit.

This guidance focuses on possible discrimination based on race or national origin. The same analysis could be adapted to evaluate relative access to credit for areas of geographical concentration on other prohibited bases—for example, age.

NOTE: It is true that neither the Equal Credit Opportunity Act (ECOA) nor the Fair Housing Act (FHA) specifically uses the term “redlining.” However, federal courts as well as agencies that have enforcement responsibilities for the FHA, have interpreted it as prohibiting institutions from having different marketing or lending practices for certain geographic areas, compared to others, where the purpose or effect of such differences would be to discriminate on a prohibited basis. Similarly, the ECOA would prohibit treating applicants for credit differently on the basis of differences in the racial or ethnic composition of their respective neighborhoods.

Like other forms of disparate treatment, redlining can be proven by overt or comparative evidence. If any written or oral policy or statement of the institution (see risk factors R6–10 in Part I, above) suggests that the institution links the racial or national origin character of an area with any aspect of access to or terms of credit, the examiners should refer to the guidance in Section B of this Part III, on documenting and evaluating overt evidence of discrimination.

Overt evidence includes not only explicit statements, but also any geographical terms used by the institution that would, to a reasonable person familiar with the community in question, connote a specific racial or national origin character. For example, if the principal information conveyed by the phrase “north of 110th Street” is that the indicated area is principally occupied by Hispanics, then a policy of not making credit available “north of 110th Street” is overt evidence of potential redlining on the basis of national origin.

Overt evidence is relatively uncommon. Consequently, the redlining analysis usually will focus on comparative evidence (similar to analyses of possible disparate treatment of individual customers) in which the institution’s treatment of areas with contrasting racial or national origin characters is compared.

When the scoping process (including consultation within an agency as called for by agency procedures) indicates that a redlining analysis should be initiated, examiners should complete the following steps of comparative analysis:

1. Identify and delineate any areas within the institution’s CRA assessment area and reasonably expected market area for residential products that have a racial or national origin character;
2. Determine whether any minority area identified in Step 1 appears to be excluded, under-served, selectively excluded from marketing efforts, or

otherwise less-favorably treated in any way by the institution;

3. Identify and delineate any areas within the institution’s CRA assessment area and reasonably expected market area for residential products that are non-minority in character and that the institution appears to treat more favorably;
4. Identify the location of any minority areas located just outside the institution’s CRA assessment area and market area for residential products, such that the institution may be purposely avoiding such areas.
5. Obtain the institution’s explanation for the apparent difference in treatment between the areas and evaluate whether it is credible and reasonable; and
6. Obtain and evaluate other information that may support or contradict interpreting identified disparities to be the result of intentional illegal discrimination.

These steps are discussed in detail below.

### Using Information Obtained during Scoping

Although the six tasks listed are presented below as examination steps in the order given above, examiners should recognize that a different order may be preferable in any given examination. For example, the institution’s explanation (Step 5) for one of the policies or patterns in question may already be documented in the CRA materials reviewed (Step 1) and the CRA examiners may already have verified it, which may be sufficient for purposes of the redlining analysis.

As another example, as part of the scoping process, the examiners may have reviewed an analysis of the geographic distribution of the institution’s loan originations with respect to the racial and national origin composition of census tracts within its CRA assessment or residential market area. Such analysis might have documented the existence of significant discrepancies between areas, by degree of minority concentration, in loans originated (risk factor R1), approval/denial rates (risk factor R2) and/or rates of denials because of insufficient collateral (risk factor R3). In such a situation in which the scoping process has produced a reliable factual record, the examiners could begin with Step 5 (obtaining an explanation) of the redlining analysis below.

In contrast, when the scoping process only yields partial or questionable information, or when the risk factors on which the redlining analysis is based on complaints or allegations against the

institution, Steps 1–4 must be addressed.

## Comparative Analysis for Redlining

*Step 1: Identify and delineate any areas within the institution's CRA assessment area and reasonably expected market area for residential products that are of a racial or national origin minority character.*

NOTE: The CRA assessment area can be a convenient unit for redlining analysis because information about it typically already is in hand. However, the CRA assessment area may be too limited. The redlining analysis focuses on the institution's decisions about how much access to credit to provide to different geographical areas. The areas for which those decisions can best be compared are areas where the institution actually marketed and provided credit and where it could reasonably be expected to have marketed and provided credit. Some of those areas might be beyond or otherwise different from the CRA assessment area.

If there are no areas identifiable for their racial or national origin minority character within the institution's CRA assessment area or reasonably expected market area for residential products, a redlining analysis is not appropriate. (If there is a substantial but dispersed minority population, potential disparate treatment can be evaluated by a routine comparative file review of applicants.)

This step may have been substantially completed during scoping, but unresolved matters may remain. (For example, several community spokespersons may allege that the institution is redlining, but disagree in defining the area). The examiners should:

- a. Describe as precisely as possible why a specific area is recognized in the community (perceptions of residents, etc.) and/or is objectively identifiable (based on census or other data) as having a particular racial or national origin minority character.
  - The most obvious identifier is the predominant race or national origin of the residents of the area. Examiners should document the percentages of racial or national origin minorities residing within the census tracts that make up the area. Analyzing racial and national origin concentrations in quartiles (such as 0 to ≤25%, >25% to ≤50%, >50% to ≤75%, and >75%) or based on majority concentration (0 to ≤50%, and >50%) may be helpful. However, examiners should bear in mind that it is illegal for the institution to consider a prohibited factor in any way. For example, an area or neighborhood may only have a minority population of 20%, but if the

area's concentration appears related to lending practices, it would be appropriate to use that area's level of concentration in the analysis. Contacts with community groups can be helpful to learn whether there are such subtle features of racial or ethnic character within a particular neighborhood.

- Geographical groupings that are convenient for CRA may obscure racial patterns. For example, an underserved, low-income, predominantly minority neighborhood that lies within a larger low-income area that primarily consisted of non-minority neighborhoods, may seem adequately served when the entire low-income area is analyzed as a unit. However, a racial pattern of underservice to minority areas might be revealed if the low-income minority neighborhood shared a border with an underserved, middle-income, minority area and those two minority areas were grouped together for purposes of analysis.

- b. Describe how the racial or national origin character changes across the suspected redlining area's various boundaries.
- c. Document or estimate the demand for credit, within the minority area. This may include the applicable demographics of the area, including the percentage of homeowners, the median house value, median family income, or the number of small businesses, etc. Review the institution's non-originated loan applications from the suspected redlined areas. If available, review aggregate institution data for loans originated and applications received from the suspected redlined areas. Community contacts may also be helpful in determining the demand for such credit. If the minority area does not have a significant amount of demand for such credit, the area is not appropriate for a redlining analysis.

*Step 2: Determine whether any minority area identified in Step 1 is excluded, under-served, selectively excluded from marketing efforts, or otherwise less-favorably treated in any way by the institution.*

The examiners should begin with the risk factors identified during the scoping process. The unfavorable treatment may have been substantially documented during scoping and needs only to be finished in this step. If not, this step will verify and measure the extent to which HMDA data show the minority areas identified in Step 1 to be underserved and/or how the institution's explicit policies treat them less favorably.

- a. Review prior CRA lending test analyses to learn whether they have identified any excluded or



otherwise under-served areas or other significant geographical disparities in the institution's lending. Determine whether any of those are the minority areas identified in Step 1.

- b. Learn from the institution itself whether, as a matter of policy, it treats any separate or distinct geographical areas within its marketing or service area differently from other areas. This may have been done completely or partially during scoping analysis related to risk factors R5–R9. The differences in treatment can be in marketing, products offered, branch operations (including the services provided and the hours of operation), appraisal practices, application processing, approval requirements, pricing, loan conditions, evaluation of collateral, or any other policy or practice materially related to access to credit. Determine whether any of those less-favored areas are the minority areas identified in Step 1.
- c. Obtain from the institution: (i) its reasons for such differences in policy, (ii) how the differences are implemented, and (iii) any specific conditions that must exist in an area for it to receive the particular treatment (more favorable or less favorable) that the institution has indicated.

*Step 3: Identify and delineate any areas within the institution's CRA assessment area and reasonably expected market area for residential products that are non-minority in character and that the institution appears to treat more favorably.*

To the extent not already completed during scoping:

- a. Document the percentages of control group and of racial or national origin minorities residing within the census tract(s) that comprise(s) the non-minority area
- b. Document the nature of the housing stock in the area
- c. Describe, to the extent known, how the institution's practices, policies, or its rate of lending change from less- to more-favorable as one leaves the minority area at its various boundaries (Examiners should be particularly attentive to instances in which the boundaries between favored and disfavored areas deviate from boundaries the institution would reasonably be expected to follow, such as political boundaries or transportation barriers)
- d. Examiners should particularly consider whether, within a large area that is composed predominantly of racial or national origin minority households, there are enclaves that are predominantly non-minority or whether, along the area's borders, there are irregularities where the non-minority group is predominant. As part

of the overall comparison, examiners should determine whether credit access within those small non-minority areas differs from credit access in the larger minority area.

*Step 4: Identify the location of any minority areas located just outside the institution's CRA assessment area and market area for residential products, such that the institution may be purposely avoiding such areas.*

Review the analysis from prior CRA examinations of whether the assessment area appears to have been influenced by prohibited factors. If there are minority areas that the institution excluded from the assessment area improperly, consider whether they ought to be included in the redlining analysis. Analyze the institution's reasonably expected market area in the same manner.

*Step 5: Obtain the institution's explanation for the apparent difference in treatment between the areas and evaluate whether it is credible and reasonable.*

This step completes the comparative analysis by soliciting from the institution any additional information not yet considered by the examiners that might show that there is a nondiscriminatory explanation for the apparent disparate treatment based on race or ethnicity.

For each matter that requires explanation, provide the institution full information about what differences appear to exist in how it treats minority and non-minority areas, and how the examiners reached their preliminary conclusions at this stage of the analysis.

- a. Evaluate whether the conditions identified by the institution in Step 2 as justifying more favorable treatment pursuant to institutional policy existed in minority neighborhoods that did not receive the favorable treatment called for by institutional policy. If there are minority areas for which those conditions existed, ask the institution to explain why the areas were treated differently despite the similar conditions.
- b. Evaluate whether the conditions identified by the institution in Step 2 as justifying less favorable treatment pursuant to institutional policy existed in non-minority neighborhoods that received favorable treatment nevertheless. If there are non-minority areas for which those conditions existed, ask the institution to explain why those areas were treated differently, despite the similar conditions.
- c. Obtain explanations from the institution for any apparent differences in treatment observed by the examiners but not called for by the institution's policies
  - If the institution's explanation cites any spe-

cific conditions in the non-minority area(s) to justify more favorable treatment, determine whether the minority area(s) identified in Step 1 satisfied those conditions. If there are minority areas for which those conditions existed, ask the institution to explain why the areas were treated differently despite the similar conditions

- If the institution's explanation cites any specific conditions in the minority area(s) to justify less favorable treatment, determine whether the non-minority area(s) had those conditions. If there are non-minority areas for which those conditions existed, ask the institution to explain why those areas were treated differently, despite the similar conditions.
- d. Evaluate the institution's responses by applying appropriate principles selected from the Appendix on *Evaluating Responses to Evidence of Disparate Treatment*.

*Step 6: Obtain and evaluate specific types of other information that may support or contradict a finding of redlining.*

As a legal matter, discriminatory intent can be inferred simply from the lack of a legitimate explanation for clearly less-favorable treatment of racial or national origin minorities. Nevertheless, if the institution's explanations do not adequately account for a documented difference in treatment, the examiners should consider additional information that might support or contradict the interpretation that the difference in treatment constituted redlining.

- a. *Comparative file review.* If there was a comparative file review conducted in conjunction with the redlining examination, review the results; or, if it is necessary and feasible to do so to clarify what appears to be discriminatory redlining, compare denied applications from within the suspected redlining area to approved applications from the contrasting area.
- Learn whether there were any denials of fully qualified applicants from the suspected redlining area. If so, that may support the view that the institution was avoiding doing business in the area.
  - Learn whether the file review identified instances of illegal disparate treatment against applicants of the same race or national origin as the suspected redlining area. If so, that may support the view that the institution was avoiding doing business with applicants of that group, such as the residents of the suspected redlining area. Learn whether any such identified victims applied for transactions in the suspected redlining area.

- If there are instances of either of the above, identify denied non-minority residents, if any, of the suspected redlining area and review their application files to learn whether they appear to have been treated in an irregular or less favorable way. If so, that may support the view that the character of the area rather than of the applicants themselves appears to have influenced the credit decisions.
- Review withdrawn and incomplete applications for the suspected redlining area, if those can readily be identified from the HMDA-LAR, and learn whether there are reliable indications that the institution discouraged those applicants from applying. If so, that may support the view that the institution was avoiding conducting business in the area and may constitute evidence of a violation of Section 202.4(b) of Regulation B.

Conversely, if the comparisons of individual transactions show that the institution treated minority and non-minority applicants within and outside the suspected redlining area similarly, that tends to contradict the conclusion that the institution avoided the areas because it had minority residents.

- b. *Interviews of third parties.* The perspectives of third parties will have been taken into account to some degree through the review of available materials during scoping. Later in the examination, in appropriate circumstances, information from third parties may help determine whether the institution's apparent differences in treatment of minority and non-minority areas constitute redlining.
- Identify persons (such as housing or credit counselors, home improvement contractors, or real estate and mortgage brokers) who may have extensive experience dealing with credit applicants from the suspected redlined area.
  - After obtaining appropriate authorization and guidance from your agency, interview those persons to learn of their first-hand experiences related to:
    - oral statements or written indications by an institution's representatives that loan applications from a suspected redlined area were discouraged;
    - whether the institution treated applicants from the suspected redlining area as called for in its own procedures (as the examiners understand them) and/or whether it treated them similarly to applicants from non-minority areas (as the examiners are familiar with those transactions);
    - any unusual delays or irregularities in loan processing for transactions in the sus-

- pected redlining area;
- differences in the institution's pricing, loan conditions, property valuation practices, etc., in the suspected redlining area compared to contrasting areas.

Also, learn from the third parties the names of any consumers they described as having experienced the questionable behavior recounted by the third party, and consider contacting those consumers.

If third parties witnessed specific conduct by the institution that indicates the institution wanted to avoid business from the area or prohibited basis group in question, this would tend to support interpreting the difference in treatment as intended. Conversely, if third parties report proper treatment or positive actions toward such area or prohibited basis group, this would tend to contradict the view that the institution intended to discriminate.

c. *Marketing.* A clear exclusion of the suspected redlining area from the institution's marketing of residential loan products supports the view that the institution did not want to do business in the area. Marketing decisions are affirmative acts to include or exclude areas. Disparities in marketing between two areas may reveal that the institution prefers one to the other. If sufficiently stark and supported by other evidence, a difference in marketing to racially different areas could itself be treated as a redlining violation of the Fair Housing Act. Even below that level of difference, marketing patterns can support or contradict the view that disparities in lending practices were intentional.

- Review materials that show how the institution has marketed in the suspected redlined area and in non-minority areas. Begin with available CRA materials and discuss the issues with CRA examiners, then review other materials as appropriate. The materials may include, for example, the institution's guidance for the geographical distribution of pre-approved solicitations for credit cards or home equity lines of credit, advertisements in local media or business or telephone directories, business development calls to real estate brokers, and calls by telemarketers.

d. *Peer performance.* Market share analysis and other comparisons to competitors are insufficient by themselves to prove that an institution engaged in illegal redlining. By the same token, an institution cannot justify its own failure to market or lend in an area by citing other institutions' failures to lend or market there.

However, an institution's inactivity in an underserved area where its acknowledged

competitors are active would tend to support the interpretation that it intends to avoid doing business in the area. Conversely, if it is as active as other institutions that would suggest that it intends to compete for, rather than avoid, business in the area.

- Develop a list of the institution's competitors.
- Learn the level of lending in the suspected redlining area by competitors. Check any public evaluations of similarly situated competitors obtained by the CRA examiners as part of evaluating the performance context or obtain such evaluations independently.

e. *Institution's record.* Request from the institution information about its overall record of serving or attempting to serve the racial or national origin minority group with which the suspected redlining area is identified. The record may reveal an intent to serve that group that tends to contradict the view that the institution intends to discriminate against the group.

NOTE: For any information that supports interpreting the situation as illegal discrimination, obtain and evaluate an explanation from the institution as called for in Part IV. If the institution's explanation is that the disparate results are the consequence of a specific, neutral policy or practice that the institution applies broadly, such as not making loans on homes below a certain value, review the guidance in the *Special Analyses* section of the Appendix under *Disproportionate Adverse Impact Violations* and consult agency managers.

## H. Analysis of Potential Discriminatory Marketing Practices

When scoping identifies significant risk factors (M1–M7) related to marketing, examiners should consult their agency's supervisory staff and experts about a possible marketing discrimination analysis. If the supervisory staff agrees to proceed, the examiners should collect information as follows:

*Step 1: Identify the institution's marketing initiatives.*

a. *Pre-approved solicitations*

- Determine whether the institution sends out pre-approved solicitations:
  - for home purchase loans
  - for home improvement loans
  - for refinance loans
- Determine how the institution selects recipients for such solicitations
  - learn from the institution its criteria for such selections
  - review any guidance or other information the institution provided credit reporting

companies or other companies that supply such lists

b. *Media Usage*

- Determine in which newspapers and broadcast media the institution advertises.
  - identify any racial or national origin identity associated with those media
  - determine whether those media focus on geographical communities of a particular racial or national origin character
- Learn the institution's strategies for geographic and demographic distribution of advertisements.
- Obtain and review copies of the institution's printed advertising and promotional materials.
- Determine what criteria the institution communicates to media about what is an attractive customer or an attractive area to cultivate business.
- Determine whether advertising and marketing are the same to racial and national origin minority areas as compared to non-minority areas.

c. *Self-produced promotional materials*

- Learn how the institution distributes its own promotional materials, both methods and geographical distribution
- Learn what the institution regards as the target audience(s) for those materials

d. *Realtors, brokers, contractors, and other intermediaries*

- Determine whether the institution solicits business from specific realtors, brokers, home improvement contractors, and other conduits.
  - learn how the institution decides which intermediaries it will solicit
  - identify the parties contacted and determine the distribution between minority and non-minority areas
  - obtain and review the types of information the institution distributes to intermediaries
  - determine how often the institution contacts intermediaries
- Determine what criteria the institution communicates to intermediaries about the type of customers it seeks or the nature of the geographic areas in which it wishes to do business.

e. *Telemarketers or predictive dialer programs*

- Learn how the institution identifies which consumers to contact, and whether the institution sets any parameters on how the list of

consumers is compiled.

*Step 2: Determine whether the institution's activities show a significantly lower level of marketing effort toward minority areas or toward media or intermediaries that tend to reach minority areas.*

*Step 3: If there is any such disparity, document the institution's explanation for it.*

For additional guidance, refer to *Part C* of the *Special Analyses* section in the Appendix.

## I. Credit Scoring

If the scoping process results in the selection of a focal point that includes a credit or mortgage scored loan product, refer to the *Considering Automated Underwriting and Credit Scoring* section of the Appendix.

If the institution utilizes a credit scoring program which scores age for any loan product selected for review in the scoping stage, either as the sole underwriting determinant or only as a guide to making loan decisions, refer to *Part E* of the *Considering Automated Underwriting and Credit Scoring* section of the Appendix.

## J. Disparate Impact Issues

These procedures have thus far focused primarily on examining comparative evidence for possible unlawful disparate treatment. Disparate impact has been described briefly in the Introduction. Whenever an examiner believes that a particular policy or practice of an institution appears to have a disparate impact on a prohibited basis, the examiner should refer to *Part A* of the *Special Analyses* section of the Appendix or consult with agency supervisory staff for further guidance.

## PART IV. OBTAINING AND EVALUATING RESPONSES FROM THE INSTITUTION AND CONCLUDING THE EXAMINATION

*Step 1. Present to the institution's management for explanation:*

- a. Any overt evidence of disparate treatment on a prohibited basis.
- b. All instances of apparent disparate treatment (e.g., overlaps) in either the underwriting of loans or in loan prices, terms, or conditions.
- c. All instances of apparent disparate treatment in the form of discriminatory steering, redlining, or marketing policies or practices.
- d. All instances where a denied prohibited basis applicant was not afforded the same level of assistance or the same benefit of discretion as

an approved control group applicant who was no better qualified with regard to the reason for denial.

- e. All instances where a prohibited basis applicant received conspicuously less favorable treatment by the institution than was customary from the institution or was required by the institution's policy.
- f. Any statistically significant average difference in either the frequency or amount of pricing disparities between control group and prohibited basis group applicants.
- g. Any evidence of neutral policies, procedures or practices that appear to have a disparate impact or effect on a prohibited basis.

Explain that unless there are legitimate, nondiscriminatory explanations (or in the case of disparate impact, a compelling business justification) for each of the preliminary findings of discrimination identified in this Part, the agency could conclude that the institution is in violation of the applicable fair lending laws.

*Step 2. Document all responses that have been provided by the institution, not just its "best" or "final" response. Document each discussion with dates, names, titles, questions, responses, any information that supports or undercuts the institution's credibility, and any other information that bears on the issues raised in the discussion(s).*

*Step 3. Evaluate whether the responses are consistent with previous statements, information obtained from file review, documents, reasonable banking practices, and other sources, and satisfy common-sense standards of logic and credibility.*

- a. Do not speculate or assume that the institution's decision-maker had specific intentions or considerations in mind when he or she took the actions being evaluated. Do not, for example, conclude that because you have noticed a legitimate, nondiscriminatory reason for a denial (such as an applicant's credit weakness), that no discrimination occurred unless it is clear that, at the time of the denial, the institution actually based the denial on that reason.
- b. Perform follow-up file reviews and comparative analyses, as necessary, to determine the accuracy and credibility of the institution's explanations.
- c. Refer to *Evaluating Responses to Evidence of Disparate Treatment* in the Appendix for guidance as to common types of responses.
- d. Refer to the *Disproportionate Adverse Impact Violations* portion of the *Special Analyses* section of the Appendix for guidance on evaluating the institution's responses to apparent disparate impact.

*Step 4. If, after completing Steps 1–3 above, you conclude that the institution has failed to adequately demonstrate that one or more apparent violations had a legitimate nondiscriminatory basis or were otherwise lawful, prepare a documented list or discussion of violations, or a draft examination report, as prescribed by agency directives.*

*Step 5. Consult with agency supervisory staff regarding whether (a) any violations should be referred to the Departments of Justice or Housing and Urban Development and (b) enforcement action should be undertaken by your agency.*

# Federal Fair Lending Regulations and Statutes

## Interagency Fair Lending Examination Procedures:

### Appendix

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#### INTRODUCTION

This Appendix offers a full range of information that might conceivably be brought to bear in an examination. In that sense, it is a “menu” of resources to be considered and selected from, depending on the nature and scope of the examination being conducted.

#### COMPLIANCE MANAGEMENT ANALYSIS CHECKLIST

This checklist is for use in conjunction with Part II of these procedures as a device for examiners to evaluate the strength of an institution’s compliance program in terms of its capacity to prevent, and to identify and self-correct fair lending violations in connection with the products or issues selected for analysis. The checklist is not intended to be an absolute test of an institution’s compliance management program. Programs containing all or most of the features described in the list may nonetheless be flawed for other reasons; conversely, a compliance program that encompasses only a

portion of the factors listed below may nonetheless adequately support a strong program under appropriate circumstances. In short, the examiner must exercise his or her best judgment in utilizing this list and in assessing the overall quality of an institution’s efforts to ensure fair lending compliance.

If the transactions within the proposed scope are covered by a listed preventive measure, and the answer is “Yes”, check the box in the first column. You may then reduce the intensity (mainly the sample size) of the planned comparative file review to the degree that the preventive measures cover transactions within the proposed scope. Document your findings in sufficient detail to justify any resulting reduction in the intensity of the examination.

You are not required to learn whether preventive measures apply to specific products outside the proposed scope. However, if the information you have obtained shows that the measure is a general practice of the institution, and thus applies to all loan products, check the box in the second column in order to assist future examination planning.

#### A. Preventive Measures

Determine whether policies and procedures exist that tend to prevent illegal disparate treatment in the transactions you plan to examine. There is no legal or agency requirement for institutions to conduct these activities. The absence of any of these policies and practices is never, by itself, a violation.

##### 1. Lending Practices and Standards:

###### a. Principal Policy Issues

- |                          |                          |   |
|--------------------------|--------------------------|---|
| <input type="checkbox"/> | <input type="checkbox"/> | Are underwriting practices clear, objective, and generally consistent with industry standards?  |
| <input type="checkbox"/> | <input type="checkbox"/> | Is pricing within reasonably confined ranges with guidance linking variations to risk and/or cost factors?  |
| <input type="checkbox"/> | <input type="checkbox"/> | Does management monitor the nature and frequency of exceptions to its standards?  |
| <input type="checkbox"/> | <input type="checkbox"/> | Are denial reasons accurately and promptly communicated to unsuccessful applicants?   |
| <input type="checkbox"/> | <input type="checkbox"/> | Are there clear and objective standards for referring applicants to (i) subsidiaries, affiliates, or other lending channels within the institution, (ii) classifying applicants as “prime” or sub-prime” borrowers, or (iii) deciding what kinds of alternative loan products should be offered or recommended to applicants? |
| <input type="checkbox"/> | <input type="checkbox"/> | Are loan officers required to document any deviation from the rate sheet?   |
| <input type="checkbox"/> | <input type="checkbox"/> | Does management monitor consumer complaints alleging discrimination in loan pricing or underwriting?  |

###### b. Do training, application-processing aids, and other guidance correctly and adequately describe:

- Prohibited bases under ECOA, Regulation B, and the Fair Housing Act?
- Other substantive credit access requirements of Regulation B (e.g. spousal signatures, improper inquiries, protected income)?

c. Is it specifically communicated to employees that they must not, on a prohibited basis:

- Refuse to deal with individuals inquiring about credit?
- Discourage inquiries or applicants by delays, discourtesy, or other means?
- Provide different, incomplete, or misleading information about the availability of loans, application requirements, and processing and approval standards or procedures (including selectively informing applicants about certain loan products while failing to inform them of alternatives)?
- Encourage or more vigorously assist only certain inquirers or applicants?
- Refer credit seekers to other institutions, more costly loan products, or potentially onerous features?
- Refer credit seekers to nontraditional products (i.e., negative amortization, "interest only," "payment option" adjustable rate mortgages) when they could have qualified for traditional mortgages?
- Waive or grant exceptions to application procedures or credit standards?
- State a willingness to negotiate?
- Use different procedures or standards to evaluate applications?
- Use different procedures to obtain and evaluate appraisals?
- Provide certain applicants opportunities to correct or explain adverse or inadequate information, or to provide additional information?
- Accept alternative proofs of creditworthiness?
- Require co-signers?
- Offer or authorize loan modifications?
- Suggest or permit loan assumptions?
- Impose late charges, reinstatement fees, etc.?
- Initiate collection or foreclosure?

d. Has the institution taken specific initiatives to prevent the following practices:

- Basing credit decisions on assumptions derived from racial, gender, and other stereotypes, rather than facts?
- Seeking consumers from a particular racial, ethnic, or religious group, or of a particular gender, to the exclusion of other types of consumers, on the basis of how "comfortable" the employee may feel in dealing with those different from him/her?
- Limiting the exchange of credit-related information or the institution's efforts to qualify an applicant from a prohibited basis group.
- Drawing the institution's CRA assessment area by unreasonably excluding minority areas?
- Targeting certain borrowers or areas with less advantageous products?

e. Does the institution have procedures to ensure that it does not:

- |                          |                          |  |
|--------------------------|--------------------------|--|
| <input type="checkbox"/> | <input type="checkbox"/> | State racial or ethnic limitations in advertisements?  |
| <input type="checkbox"/> | <input type="checkbox"/> | Employ code words or use photos in advertisements that convey racial or ethnic limitations or preferences?             |
| <input type="checkbox"/> | <input type="checkbox"/> | Place advertisement that a reasonable person would regard as indicating minority consumers are less desirable?         |
| <input type="checkbox"/> | <input type="checkbox"/> | Advertise only in media serving predominantly minority or non-minority areas of the market?                            |
| <input type="checkbox"/> | <input type="checkbox"/> | Conduct other forms of marketing differentially in minority or non-minority areas of the market?                       |
| <input type="checkbox"/> | <input type="checkbox"/> | Market only through brokers known to serve only one racial or ethnic group in the market?                              |
| <input type="checkbox"/> | <input type="checkbox"/> | Use a prohibited basis in any pre-screened solicitation?   |
| <input type="checkbox"/> | <input type="checkbox"/> | Provide financial incentives for loan officers to place applicants in nontraditional products or higher-risk products? |

2. Compliance Audit Function: Does the Institution Attempt to Detect Prohibited Disparate Treatment by Self-Test or Self-Evaluation?

NOTE: A self-test is any program, practice or study that is designed and specifically used to assess the institution's compliance with the ECOA and the Fair Housing Act. It creates data or factual information that is not otherwise available and cannot be derived from loan, application or other records related to credit transactions (12 CFR 202.15(b)(1) and 24 CFR 100.141). The report, results, and many other records associated with a self-test are privileged unless an institution voluntarily discloses the report or results or otherwise forfeits the privilege. See 12 CFR 202.15(b)(2) and 24 CFR 100.142(a) for a complete listing of the types of information covered by the privilege. A self-evaluation, while generally having the same purpose as a self-test, does not create any new data or factual information, but uses data readily available in loan or application files and other records used in credit transactions and, therefore, does not meet the self-test definition. See *Using Self-Tests and Self-Evaluations to Streamline the Examination* in this Appendix for more information about self-tests and self-evaluations.

While you may request the results of self-evaluations, you should not request the results of self-tests or any of the information listed in 12 CFR 202.15(b)(2) and 24 CFR 100.142(a). If an institution discloses the self-test report or results to its regulator, it will lose the privilege. The following items are intended to obtain information about the institution's approach to self-testing and self-evaluation, not the findings. Complete the checklist below for each self-evaluation and each self-test, where the institution voluntarily discloses the report or results. Evaluating the results of self-evaluations and voluntarily disclosed self-tests is described in *Using Self-tests and Self-Evaluations to Streamline the Examination* in this Appendix.

a. Are the transactions reviewed by an independent analyst who:

- |                          |                          |  |
|--------------------------|--------------------------|--|
| <input type="checkbox"/> | <input type="checkbox"/> | Is directed to report objective results? |
| <input type="checkbox"/> | <input type="checkbox"/> | Has an adequate level of expertise?      |
| <input type="checkbox"/> | <input type="checkbox"/> | Produces written conclusions?            |

b. Does the institution's approach for self-testing or self-evaluation call for:

- |                          |                          |  |
|--------------------------|--------------------------|--|
| <input type="checkbox"/> | <input type="checkbox"/> | Attempting to explain major patterns shown in the HMDA or other loan data?   |
| <input type="checkbox"/> | <input type="checkbox"/> | Determining whether actual practices and standards differ from stated ones and basing the evaluation on the actual practices?                            |
| <input type="checkbox"/> | <input type="checkbox"/> | Evaluating whether the reasons cited for denial are supported by facts relied on by the decision maker at the time of the decision?                      |
| <input type="checkbox"/> | <input type="checkbox"/> | Comparing the treatment of prohibited basis group applicants to control group applicants?  |
| <input type="checkbox"/> | <input type="checkbox"/> | Obtaining explanations from decision makers for any unfavorable treatment of the prohibited basis group that departed from policy or customary practice? |



- Covering significant decision points in the loan process where disparate treatment or discouragement might occur, including:
  - The approve/deny decision?
  - Pricing?
  - Other terms and conditions?
- Covering at least as many transactions as examiners would independently, if using the Fair Lending Sample Size Tables for a product with the application volumes of the product to be evaluated?
- Maintaining information concerning personal characteristics collected as part of a self-test separately from application or loan files?
- Timely analysis of the data?
- Taking appropriate and timely corrective action?

c. In the institution's plan for comparing the treatment of prohibited basis group applicants with that of control group applicants:

- Are control and prohibited basis groups based on a prohibited basis found in ECOA or the FHAct and defined clearly to isolate that prohibited basis for analysis?
- Are appropriate data to be obtained to document treatment of applicants and the relative qualifications vis-a-vis the requirement in question?
- Will the data to be obtained reflect the data on which decisions were based?
- Does the plan call for comparing the denied applicants' qualifications related to the stated reason for denial with the corresponding qualifications for approved applicants?
- Are comparisons designed to identify instances in which prohibited basis group applicants were treated less favorably than control group applicants who were no better qualified?
- Is the evaluation designed to determine whether control and prohibited basis group applicants were treated differently in the processes by which the institution helped applicants overcome obstacles and by which their qualifications were enhanced?
- Are responses and explanations to be obtained for any apparent disparate treatment on a prohibited basis or other apparent violations of credit rights?
- Are reasons cited by credit decision makers to justify or explain instances of apparent disparate treatment to be verified?

d. For self-tests under ECOA that involved the collection of applicant personal characteristics, did the institution:

1. develop a written plan that describes or identifies the:

- specific purpose of the self-test?
- methodology to be used?
- geographic area(s) to be covered?
- type(s) of credit transactions to be reviewed?
- entity that will conduct the test and analyze the data?
- timing of the test, including start and end dates or the duration of the self- test?
- other related self-test data that is not privileged?

2. disclose at the time applicant characteristic information is requested, that:

- the applicant will not be required to provide the information?
- the creditor is requesting the information to monitor its compliance with ECOA?
- federal law prohibits the creditor from discriminating on the basis of this information or on the basis of an applicant's decision not to furnish the information?
- if applicable, certain information will be collected based on visual observation or surname if not provided by the applicant?

## B. Corrective Measures

a. Determine whether the institution has provisions to take appropriate corrective action and provide adequate relief to victims for any violations in the transactions you plan to review. Who is to receive the results of a self-evaluation or voluntarily disclosed self-test? What decision process is supposed to follow delivery of the information? Is feedback to be given to staff whose actions are reviewed? What types of corrective action may occur? Are consumers to be:

- Offered credit if they were improperly denied?
- Compensated for any damages, both out of pocket and compensatory?
- Notified of their legal rights?

b. Other corrective action:

- Are institutional policies or procedures that may have contributed to the discrimination to be corrected?
- Are employees involved to be trained and/or disciplined?
- Is the need for community outreach programs and/or changes in marketing strategy or loan products to better serve minority segments of the institution's market to be considered?
- Are audit and oversight systems to be improved in order to ensure there is not recurrence of any identified discrimination?

## CONSIDERING AUTOMATED UNDERWRITING AND CREDIT SCORING

These procedures are designed to help an examiner draw and support fair lending conclusions in situations involving automated underwriting or credit scoring.

### A. Structure and Organization of the Scoring System

Determine the utilization of credit scoring at the institution including

1. For each customized credit scoring model or scorecard for any product, or for any credit scoring model used in connection with a product held in portfolio, identify and obtain:
  - a. the number and inter-relationship of each model or scorecard applied to a particular product;
  - b. the purposes for which each scorecard is

employed (e.g., approval decision, set credit limits, set pricing, determine processing requirements, etc.);

- c. the developer of each scorecard used (e.g., in-house department, affiliate, independent vendor name) and describe the development population utilized;
- d. the types of monitoring reports generated (including front-end, back-end, account management and any disparate impact analyses), the frequency of generation and recent copies of each;
- e. all policies applicable to the use of credit scoring;
- f. training materials and programs on credit scoring for employees, agents and brokers involved in any aspect of retail lending;
- g. any action taken to revalidate or re-calibrate any model or scorecard used during the exam period and the reason(s) why;
- h. the number of all high-side and low-side

overrides for each type of override occurring during the exam period and any guidance given to employees on their ability to override;

- i. all cutoffs used for each scorecard throughout the examination period and the reasons for the cutoffs and any change made during the exam period;
  - j. all variables scored by each product's scorecard(s) and the values that each variable may take; and
  - k. the method used to select for disclosure those adverse action reasons arising from application of the model or scorecard.
2. For each judgmental underwriting system that includes as an underwriting criterion a standard credit bureau or secondary market credit score, identify:
    - a. the vendor of each credit score and any vendor recommendation or guidance on the usage of the score relied upon by the institution;
    - b. the institution's basis for using the particular bureau or secondary market score and the cutoff standards for each product's underwriting system and the reasons for the cutoffs and any changes to the same during the exam period;
    - c. the number of exceptions or overrides made to the credit score component of the underwriting criteria and the basis for those exceptions or overrides, including any guidance given to employees on their ability to depart from credit score underwriting standards; and
    - d. types of monitoring reports generated on the judgmental system or its credit scoring component (including front-end, back-end, differential processing and disparate impact analysis), the frequency of generation and recent copies of each.

## B. Adverse Action Disclosure Notices

Determine the methodology used to select the reasons why adverse action was taken on a credit application denied on the basis of the applicant's credit score. Compare the methodology used to the examples recited in the Commentary to Regulation B and decide acceptability against that standard. Identify any consumer requests for reconsideration of credit score denial reasons and review the action taken by management for consistency across applicant groups.

Where a credit score is used to differentiate application processing, and an applicant is denied

for failure to attain a judgmental underwriting standard that would not be applied if the applicant had received a better credit score (thereby being considered in a different—presumably less stringent—application processing group), ensure that the adverse action notice also discloses the bases on which the applicant failed to attain the credit score required for consideration in the less stringent processing group.

## C. Disparate Treatment in the Application of Credit Scoring Programs

1. Determine what controls and policies management has implemented to ensure that the institution's credit scoring models or credit score criteria are not applied in a discriminatory manner, in particular:
  - a. Examine institution guidance on using the credit scoring system, on handling overrides and on processing applicants and how well that guidance is understood and observed by the targeted employees and monitored for compliance by management; and
  - b. Examine institution policies that permit overrides or that provide for different processing or underwriting requirements based on geographic identifiers or borrower score ranges to assure that they do not treat protected group applicants differently than other similarly situated applicants.
2. Evaluate whether any of the bases for granting credit to control group applicants who are low-side overrides are applicable to any prohibited basis denials whose credit score was equal to or greater than the lowest score among the low-side overrides. If such cases are identified, obtain and evaluate management's reason for why such different treatment is not a fair lending violation.
3. Evaluate whether any of the bases for denying credit to any prohibited basis applicants who are high-side overrides are applicable to any control group approvals whose credit score was equal to or less than the highest score among the prohibited basis high-side overrides. If such cases are identified, obtain and evaluate management's reason for why such different treatment is not a fair lending violation.
4. If credit scores are used to segment applicants into groups that receive different processing or are required to meet additional underwriting requirements (e.g., "tiered risk underwriting"), perform a comparative file review, or confirm the results and adequacy of management's comparative file review, that evaluates whether all applicants within each group are treated equally.

## D. Disparate Impact and Credit Scoring Algorithms

Consult with agency supervisory staff to assess potential disparate treatment issues relating to the credit scoring algorithm.

## E. Credit Scoring Systems that Include Age

Regulation B expressly requires the initial validation and periodic revalidation of a credit scoring system that considers age. There are two ways a credit scoring system can consider age: 1) the system can be split into different scorecards depending on the age of the applicant; and 2) age may be directly scored as a variable. Both features may be present in some systems. Regulation B requires that all credit scoring systems that consider age in either of these ways must be validated (in the language of the regulation, empirically derived, demonstrably and statistically sound (EDDSS)).

1. **Age-Split Scorecards:** If a system is split into only two cards and one card covers a wide age range that encompasses elderly applicants (applicants 62 or older), the system is treated as considering, but not scoring, age. Typically, the younger scorecard in an age-split system is used for applicants under a specific age between 25 and 30. It de-emphasizes factors such as the number of trade lines and the length of employment, and increases the negative weight of any derogatory information on the credit report. Systems such as these do not raise the issue of assigning a negative factor or value to the age of an elderly applicant. However, if age is directly scored as a variable (whether or not the system is age-split), or if elderly applicants are included in a card with a narrow age range in an age-split system, the system is treated as scoring age.
2. **Scorecards that Score Age:** If a scorecard scores age directly, in addition to meeting the EDDSS requirement, the creditor must ensure that the age of an elderly applicant is not assigned a negative factor or value. (See the staff commentary at 12 CFR 202.2(p) and 202.6(b)(2)). A negative factor or value means utilizing a factor, value, or weight that is less favorable than the creditor's experience warrants or is less favorable than the factor, value, or weight assigned to the most favored age group below the age of 62 (12 CFR 202.2(v)).

## F. Examination for Empirical Derivation and Statistical Soundness

Regulation B requires credit scoring systems that use age to be empirically derived, and demonstra-

bly and statistically sound. This means that they must fulfill the requirements of 12 CFR 202.2(p)(1)(i)–(iv). Obtain documentation provided by the developer of the system and consult the agency's most recent guidance for making that determination.

## EVALUATING RESPONSES TO EVIDENCE OF DISPARATE TREATMENT

### A. Responses to Comparative Evidence of Disparate Treatment

The following are responses that an institution may offer—separately or in combination—to attempt to explain that the appearance of illegal disparate treatment is misleading, and that no violation has in fact occurred. The responses, if true, may rebut the appearance of disparate treatment. The examiners must evaluate the validity and credibility of the responses.

1. *The institution's personnel were unaware of the prohibited basis identity of the applicant(s)*

If the institution claims to have been unaware of the prohibited basis identity (race, etc.) of an applicant or neighborhood, ask it to show that the application in question was processed in such a way that the institution's staff that made the decisions could not have learned the prohibited basis identity of the applicant.

If the product is one for which the institution maintains prohibited basis monitoring information, assume that all employees could have taken those facts into account. Assume the same when there was face-to-face contact between any employee and the consumer.

If there are other facts about the application from which an ordinary person would have recognized the applicant's prohibited basis identity (for example, the surname is an easily recognizable Hispanic one), assume that the institution's staff drew the same conclusions. If the racial character of a community is in question, ask the institution to provide persuasive evidence why its staff would *not* know the racial character of any community in its service area.

2. *The difference in treatment was justified by differences in the applicants (applicants not "similarly situated")*

Ask the institution to account for the difference in treatment by pointing out a specific difference between the applicants' qualifications, or some factor not captured in the application but that legitimately makes one applicant more or less attractive to the institution, or some non-prohibited factor related to the processing of

their applications. The difference identified by the institution must be one that is important enough to justify the difference in treatment in question, not a meaningless difference.

The factors commonly cited to show that applicants are not similarly situated fall into two groups: those that can be evaluated by how consistently they are handled in other transactions, and those that cannot be evaluated in that way.

a. Verifying "not similarly situated" explanations by consistency

The appearance of disparate treatment remains if a factor cited by the institution to justify favorable treatment for a control group applicant also exists for an otherwise similar prohibited basis applicant who was treated unfavorably. Similarly, the appearance of disparate treatment remains if a factor cited by the institution to justify unfavorable treatment for a prohibited basis applicant also exists for a control group applicant that got favorable treatment. If this is not so, ask the institution to document that the factor cited in its explanation was used consistently for control group and prohibited basis applicants.

Among the responses that should be evaluated this way are:

- *Customer relationship.* Ask the institution to document that a customer relationship was also sometimes considered to the benefit of prohibited basis applicants and/or that its absence worked against control group customers.
- *"Loan not saleable or insurable."* If file review is still in progress, be alert for loans approved despite the claimed fatal problem. At a minimum, ask the institution to be able to produce the text of the secondary market or insurer's requirement in question.
- *Difference in standards or procedures between branches or underwriters.* Ask the institution to provide transactions documenting that each of the two branches or underwriters applied its standards or procedures consistently to both prohibited basis and control group applications it processed, and that each served similar proportions of the prohibited basis group.
- *Difference in applying the same standard (difference in "strictness") between underwriter, branches, etc.* Ask the institution to provide transactions documenting that the stricter employee, branch, etc., was strict for both prohibited basis and control group

applicants and that the other was lenient for both, and that each served similar proportions of the prohibited basis group. The best evidence of this would be prohibited basis applicants who received favorable treatment from the lenient branch and control group applicants who received less favorable treatment from the "strict" branch.

- *Standards or procedures changed during period reviewed.* Ask the institution to provide transactions documenting that during each period the standards were applied consistently to both prohibited basis and control group applicants.
  - *Employee misunderstood standard or procedure.* Ask the institution to provide transactions documenting that the misunderstanding influenced both prohibited basis and control group applications. If that is not available, find no violation if the misunderstanding is a reasonable mistake.
- b. Evaluating "not similarly situated" explanations by other means

If consistency cannot be evaluated, consider an explanation favorably even without examples of its consistent use if:

- the factor is documented to exist in (or be absent from) the transactions, as claimed by the institution;
- the factor is one a prudent institution would consider and is consistent with the institution's policies and procedures;
- file review found no evidence that the factor is applied selectively on a prohibited basis (in other words, the institution's explanation is "not inconsistent with available information"); and
- the institution's description of the transaction is generally consistent and reasonable.

Some factors that may be impossible to compare for consistency are:

- *Unusual underwriting standard.* Ask the institution to show that the standard is prudent. If the standard is prudent and not inconsistent with other information, accept this explanation even though there is no documentation that it is used consistently.
- *"Close calls."* The institution may claim that underwriters' opposite decisions on similar applicants reflects legitimate discretion that the examiners should not second guess. That is not an acceptable explanation for identical applicants with different results, but is acceptable when the applicants have differing strengths and weak-

nesses that different underwriters might reasonably weigh differently. However, do not accept the explanation if other files reveal that these "strengths" or "weaknesses" are counted or ignored selectively on a prohibited basis.

- *"Character loan."* Expect the institution to identify a specific history or specific facts that make the applicant treated favorably a better risk than those treated less favorably.
- *"Accommodation loan."* There are many legitimate reasons that may make a transaction appealing to an institution apart from the familiar qualifications demanded by the secondary market and insurers. For example, a consumer may be related to or referred by an important customer, be a political or entertainment figure who would bring prestige to the institution, be an employee of an important business customer, etc. It is not illegal discrimination to make a loan to an otherwise unqualified control group applicant who has such attributes while denying a loan to an otherwise similar prohibited basis applicant without them. However, be skeptical when the institution cites reasons for "accommodations" that an ordinary prudent institution would not value.
- *"Gut feeling."* Be skeptical when institutions justify an approval or denial by a general perception or reaction to the consumer. Such a perception or reaction may be linked to a racial or other stereotype that legally must not influence credit decisions. Ask whether any specific event or fact generated the reaction. Often, the institution can cite something specific that made him or her confident or uncomfortable about the consumer. There is no discrimination if it is credible that the institution indeed considered such a factor and did not apply it selectively on a prohibited basis.

c. Follow up customer contacts

If the institution's explanation of the handling of a particular transaction is based on consumer traits, actions, or desires not evident from the file, consider obtaining agency authorization to contact the consumer to verify the institution's description. Such contacts need not be limited to possible victims of discrimination, but can include control group applicants or other witnesses.

3. *The different results stemmed from an inadvert-*

*ent error*

If the institution claims an identified error such as miscalculation or misunderstanding caused the favorable or unfavorable result in question, evaluate whether the facts support the assertion that such an event occurred.

If the institution claims an unidentified error caused the favorable or unfavorable result in question, expect the institution to provide evidence that discrimination is inconsistent with its demonstrated conduct, and therefore that discrimination is the less logical interpretation of the situation. Consider the context (as described below).

4. *The apparent disparate treatment on a prohibited basis is a misleading portion of a larger pattern of random inconsistencies*

Ask the institution to provide evidence that the unfavorable treatment is not limited to the prohibited basis group and that the favorable treatment is not limited to the control group. Without such examples, do not accept an institution's unsupported claim that otherwise inexplicable differences in treatment are distributed randomly.

If the institution can document that similarly situated prohibited basis group applicants received the favorable treatment in question approximately as frequently and in comparable degree as the control group applicants, conclude there is no violation.

NOTE: Transactions are relevant to "random inconsistency" only if they are "similarly situated" to those apparently treated unequally.

5. *Loan terms and conditions*

The same analyses described in the preceding sections with regard to decisions to approve or deny loans also apply to pricing differences. Risks and costs are legitimate considerations in setting prices and other terms and conditions of loan products. However, generalized reference by the institution to "cost factors" is insufficient to explain pricing differences.

If the institution claims that specific borrowers received different terms or conditions because of cost or risk considerations, ask the institution to be able to identify specific risk or cost differences between them.

If the institution claims that specific borrowers received different terms or conditions because they were not similarly situated as negotiators, consider whether application records might provide relevant evidence. If the records are not helpful, consider seeking authorization to contact consumers to learn whether the institution in fact behaved comparably toward prohibited basis and control group consumers. The contacts would be to learn such information as the institution's opening quote of terms to the

consumer and the progress of the negotiations.

If the institution responds that an average price difference between the control and prohibited basis groups is based on cost or risk factors, ask it to identify specific risk or cost differences between individual control group applicants with the lowest rates and prohibited basis group applicants with the highest rates that are significant enough to justify the pricing differences between them. If the distinguishing factors cited by the institution are legitimate and verifiable as described in the sections above, remove those applications from the average price calculation. If the average prices for the remaining control group and prohibited basis group members still differ more than minimally, consult agency supervisory staff about further analysis. Findings or violations based on disparate treatment or disparate impact regarding cost or risk factors should be discussed with agency supervisory staff.

## B. Responses to Overt Evidence of Disparate Treatment

### 1. *Descriptive references vs. lending considerations*

A reference to race, gender, etc., does not constitute a violation if it is merely descriptive—for example, “the applicant was young.” In contrast, when the reference reveals that the prohibited factor influenced the institution’s decisions and/or consumer behavior, treat the situation as an apparent violation to which the institution must respond.

### 2. *Personal opinions vs. lending considerations*

If an employee involved with credit availability states unfavorable views regarding a racial group, gender, etc., but does not explicitly relate those views to credit decisions, review that employee’s credit decisions for possible disparate treatment of the prohibited basis group described unfavorably. If there are no instances of apparent disparate treatment, treat the employee’s views as permissible private opinions. Inform the institution that such views create a risk of future violations.

### 3. *Stereotypes related to credit decisions*

There is an apparent violation when a prohibited factor influences a credit decision through a stereotype related to creditworthiness—for example, a loan denial because “a single woman could not maintain a large house.” If the stereotyped beliefs are offered as “explanations” for unfavorable treatment, regard such unfavorable treatment as apparent illegal disparate treatment. If the stereotype is only a general observation unrelated to particular transactions, review that employee’s credit decisions for

possible disparate treatment of the prohibited basis group in question. Inform the institution that such views create a risk of future violations.

### 4. *Indirect reference to a prohibited factor*

If negative views related to creditworthiness are described in non-prohibited terms, consider whether the terms would commonly be understood as surrogates for prohibited terms. If so, treat the situation as if explicit prohibited basis terms were used. For example, an institution’s statement that “It’s too risky to lend north of 110th Street” might be reasonably interpreted as a refusal to lend because of race if that portion of the institution’s lending area north of 110th Street were predominantly black and the area south, white.

### 5. *Lawful use of a prohibited factor*

#### a. Special Purpose Credit Program (SPCP)

If an institution claims that its use of a prohibited factor is lawful because it is operating an SPCP, ask the institution to document that its program conforms to the requirements of Regulation B. An SPCP must be defined in a written plan that existed before the institution made any decisions on loan applications under the program. The written plan must:

- demonstrate that the program will benefit persons who would otherwise be denied credit or receive credit on less favorable terms; and
- state the time period the program will be in effect or when it will be re-evaluated.

No provision of an SPCP should deprive people who are not part of the target group of rights or opportunities they otherwise would have. Qualified programs operating on an otherwise-prohibited basis will not be cited as a violation.

NOTE: Advise the institution that an agency finding that a program is a lawful SPCP is not absolute security against legal challenge by private parties. Suggest that an institution concerned about legal challenge from other quarters use exclusions or limitations that are not prohibited by ECOA or the FHAct, such as “first-time home buyer.”

#### b. Second review program

Such programs are permissible if they do no more than ensure that lending standards are applied fairly and uniformly to all applicants. For example, it is permissible to review the proposed denial of applicants who are members of a prohibited basis group by comparing their applications to the approved applications of similarly qualified individuals who are in the control group to

determine if the applications were evaluated consistently.

Ask the institution to demonstrate that the program is a safety net that merely attempts to prevent discrimination, and does not involve underwriting terms or practices that are preferential on a prohibited basis.

Statements indicating that the mission of the program is to apply different standards or efforts on behalf of a particular racial or other group constitute overt evidence of disparate treatment. Similarly, there is an apparent violation if comparative analysis of appli-

cants who are processed through the second review and those who are not discloses dual standards related to the prohibited basis.

- c. Affirmative marketing/advertising program:  
Affirmative advertising and marketing efforts that do not involve application of different lending standards are permissible under both the ECOA and the FHAct. For example, special outreach to a minority community would be permissible.

## FAIR LENDING SAMPLE SIZE TABLES

**Table A. Underwriting (Accept/Deny) Comparisons**

	Sample 1. Prohibited Basis Denials			Sample 2. Control Group Approvals		
Number of Denials or Approvals	5–50	51–150	>150	20–50	51–250	>250
Minimum to review:	All	51	75	20	51	100
Maximum to review:	50	100	150	5x prohibited basis sample (up to 50)	5x prohibited basis sample (up to 125)	5x prohibited basis sample (up to 300)

**Table B. Terms and Conditions Comparisons**

	Sample 1. Prohibited Basis Approvals			Sample 2. Control Group Approvals		
Number of Approvals	5–25	26–100	>100	20–50	51–250	>250
Minimum to review:	All	26	50	20	40	60
Maximum to review:	25	50	75	5x prohibited basis sample (up to 50)	5x prohibited basis sample (up to 75)	5x prohibited basis sample (up to 100)

### *Explanatory Notes to Sample Size Tables*

1. Examiners should not follow Table B when conducting a pricing review that involves a regression analysis. Consult with agency supervisory staff for specific protocol in these cases.
2. When performing both underwriting and terms and conditions comparisons, use the same control group approval sample for both tasks.
3. If there are fewer than 5 prohibited basis denials or 20 control group approvals, refer to "Sample Size" instructions in the procedures.
4. "Minimum" and "maximum" sample sizes: select a sample size between the minimum and maximum numbers identified above. Examiners should base the size of their review on the level of risk identified during the preplanning and scoping procedures. Once the sample size has been determined, select individual transactions judgmentally. Refer to procedures.
5. If two prohibited basis groups (e.g., black and Hispanic) are being compared against one control group, select a control group that is 5 times greater than the larger prohibited basis group sample, up to the maximum.
6. Where the institution's discrimination risk profile identifies significant discrepancies in withdrawal/incomplete activity between control and prohibited basis groups, or where the number of marginal prohibited basis group files available for sampling is small, an examiner may consider supplementing



samples by applying the following rules:

- If prohibited basis group withdrawals/incompletes occur after the applicant has received an offer of credit that includes pricing terms, this is a reporting error under Regulation C (the institution should have reported the application as approved but not accepted) and therefore these applications should be included as prohibited basis group approvals in a terms and conditions comparative file analysis.
- If prohibited basis group incompletes occur due to lack of an applicant response with respect to an item that would give rise to a denial reason, then include them as denials for that reason when conducting an underwriting comparative file analysis.

## IDENTIFYING MARGINAL TRANSACTIONS

These procedures are intended to assist an examiner in identifying denied and approved applications that were not either clearly qualified or unqualified, i.e., marginal transactions.

### A. Marginal Denials

Denied applications with any or all the following characteristics are "marginal." Such denials are compared to marginal approved applications. Marginal denied applications include those that:

- Were close to satisfying the requirement that the adverse action notice said was the reason for denial;
- Were denied by the institution's rigid interpretation of inconsequential processing requirements;
- Were denied quickly for a reason that normally would take a longer time for an underwriter to evaluate;
- Involved an unfavorable subjective evaluation of facts that another person might reasonably have interpreted more favorably (for example, whether late payments actually showed a "pattern," or whether an explanation for a break in employment was "credible");
- Resulted from the institution's failure to take reasonable steps to obtain necessary information;
- Received unfavorable treatment as the result of a departure from customary practices or stated policies. For example, if it is the institution's stated policy to request an explanation of derogatory credit information, a failure to do so for a prohibited basis applicant would be a departure from customary practices or stated policies even if the derogatory information seems to be egregious;
- Were similar to an approved control group applicant who received unusual consideration or service, but were not provided such consideration or service;
- Received unfavorable treatment (for example, were denied or given various conditions or more

processing obstacles) but appeared fully to meet the institution's stated requirements for favorable treatment (for example, approval on the terms sought);

- Received unfavorable treatment related to a policy or practice that was vague, and/or the file lacked documentation on the applicant's qualifications related to the reason for denial or other factor;
- Met common secondary market or industry standards even though failing to meet the institution's more rigid standards;
- Had a strength that a prudent institution might believe outweighed the weaknesses cited as the basis for denial;
- Had a history of previously meeting a monthly housing obligation equivalent to or higher than the proposed debt; and/or
- Were denied for an apparently "serious" deficiency that might easily have been overcome. For example, an applicant's total debt ratio of 50 percent might appear grossly to exceed the institution's guideline of 36 percent, but this may in fact be easily corrected if the application lists assets to pay off sufficient nonhousing debts to reduce the ratio to the guideline, or if the institution were to count excluded part-time earnings described in the application.

### B. Marginal Approvals

Approved applications with any or all of the following characteristics are "marginal." Such approvals are compared to marginal denied applications. Marginal approvals include those:

- Whose qualifications satisfied the institution's stated standard, but very narrowly;
- That bypassed stated processing requirements (such as verifications or deadlines);
- For which stated creditworthiness requirements were relaxed or waived;
- That, if the institution's own standards are not clear, fell short of common secondary market or industry lending standards;
- That a prudent conservative institution might

have denied;

- Whose qualifications were raised to a qualifying level by assistance, proposals, counteroffers, favorable characterizations or questionable qualifications, etc.; and/or
- That in any way received unusual service or consideration that facilitated obtaining the credit.

## POTENTIAL SCOPING INFORMATION

As part of the scoping process described in Part I of the procedures, examiners will need to gather documents and information to sufficiently identify their focal points for review. Below is a list of suggested information that examiners may wish to gather internally, as well as from the institution itself.

### A. Internal Agency Documents and Records

1. Previous examination reports and related work papers for the most recent Compliance/CRA and Safety and Soundness Examinations.
2. Complaint information.
3. Demographic data for the institution's community.

*Comment:* The examiner should obtain the most recent agency demographic data, for information on the characteristics of the institution's assessment/market areas.

### B. Information from the Institution

*Comment:* Prior to beginning a compliance examination, the examiner should request the institution to provide the information outlined below. This request should be made far enough in advance of the on-site phase of the examination to facilitate compliance by the institution. In some institutions, the examiner may not be able to review certain of this information until the on-site examination. The examiner should generally request only those items that correspond to the time period(s) being examined.

1. *Institution's Compliance Program* (For examinations that will include analysis of the institution's compliance program.)
  - a. Organization charts identifying those individuals who have lending responsibilities or compliance, HMDA or CRA responsibilities, together with job descriptions for each such position.
  - b. Lists of any pending litigation or administrative proceedings concerning fair lending matters.
  - c. Results of self-evaluations or self-tests (where

the institution chooses to share self-test results), copies of audit or compliance reviews of the institution's program for compliance with fair lending laws and regulations, including both internal and independent audits.

*NOTE:* The request should advise the institution that it is not required to disclose the report or results of any self-tests of the type protected under amendments to ECOA and the FHAct programs.

- d. Complaint file.
  - e. Any written or printed statements describing the institution's fair lending policies and/or procedures.
  - f. Training materials related to fair lending issues including records of attendance.
  - g. Records detailing policy exceptions or overrides, exception reporting and monitoring processes.
2. *Lending Policies / Loan Volume*
    - a. Internal underwriting guidelines and lending policies for all consumer and commercial loan products.
 

*Comment:* If guidelines or policies differ by branch or other geographic location, request copies of each variation.
    - b. A description of any credit scoring system(s) in use now or during the exam period.
 

*Comment:* Inquire as to whether a vendor or in-house system is used; the date of the last verification; the factors relied on to construct any in-house system and, if applicable, any judgmental criteria used in conjunction with the scoring system.
    - c. Pricing policies for each loan product, and for both direct and indirect loans.
 

*Comment:* The institution should be specifically asked whether its pricing policies for any loan products include the use of "overages". The request should also ask whether the institution offers any "sub-prime" loan products or otherwise uses any form of risk-based pricing. A similar inquiry should be made regarding the use of any cost-based pricing. If any of these three forms are or have been in use since the last exam, the institution should provide pricing policy and practice details for each affected product, including the institution's criteria for differentiating between each risk or cost level and any policies regarding overages. Regarding indirect lending, the institution should be asked to provide any forms of agreement (including compensation) with brokers/dealers, together with a description of the

roles that both the institution and the dealer/broker play in each stage of the lending process.

- d. A description of each form of compensation plan for all lending personnel and managers.
- e. Advertising copy for all loan products.
- f. The most recent HMDA / LAR, including unreported data if available.

*Comment:* The integrity of the institution's HMDA-LAR data should be verified prior to the pre-examination analysis.

- g. Any existing loan registers for each non-HMDA loan product.

*Comment:* Loan registers for the 3 month period preceding the date of the examination, together with any available lists of declined loan applicants for the same period should be requested. Registers / lists should contain, to the extent available, the complete name and address of loan applicants and applicable loan terms, including loan amount, interest rate, fees, repayment schedule and collateral codes.

- h. A description of any application or loan-level data bases maintained, including a description of all data fields within the database or that can be linked at the loan-level.
- i. Forms used in the application and credit evaluation process for each loan product.

*Comment:* At a minimum, this request should include all types of credit applications, forms requesting financial information, underwriter worksheets, any form used for the collection of monitoring information, and any quality control or second review forms or worksheets.

- j. Lists of service providers.

*Comment:* Service providers may include: brokers, realtors, real estate developers, appraisers, underwriters, home improvement contractors and private mortgage insurance companies. Request the full name and address and geographic area served by each provider. Also request documentation as to any fair lending requirements imposed on, or commitments required of, any of the institution's service providers.

- k. Addresses of any Internet Site(s)

*Comment:* Internet "Home Pages" or similar sites that an institution may have on the Internet may provide information concerning the availability of credit, or means for obtaining it. All such information must comply with the nondiscrimination requirements of the fair lending laws. In view of the increasing capability to conduct transactions on the

Internet, it is extremely important for examiners to review an institution's Internet sites to ensure that all of the information or procedures set forth therein are in compliance with any applicable provisions of the fair lending statutes and regulations.

### 3. Community Information

- a. Demographic information prepared or used by the institution.
- b. Any fair lending complaints received and institution responses thereto.

## SPECIAL ANALYSES

These procedures are intended to assist examiners who encounter disproportionate adverse impact violations, discriminatory pre-application screening and possible discriminatory marketing.

### A. Disproportionate Adverse Impact Violations

When all five conditions below exist, consult within your agency to determine whether to present the situation to the institution and solicit the institution's response. Note that condition 5 can be satisfied by either of two alternatives.

The contacts between examiners and institutions described in this section are information-gathering contacts within the context of the examination and are not intended to serve as the formal notices and opportunities for response that an agency's enforcement process might provide. Also, the five conditions are not intended as authoritative statements of the legal elements of a disproportionate adverse impact proof of discrimination; they are paraphrases intended to give examiners practical guidance on situations that call for more scrutiny and on what additional information is relevant.

**NOTE:** Even if it appears likely that a policy or criterion causes a disproportionate adverse impact on a prohibited basis (condition 3), consult agency supervisory staff if the policy or criterion is obviously related to predicting creditworthiness and is used in a way that is commensurate with its relationship to creditworthiness, or is obviously related to some other basic aspect of prudent lending, and there appears to be no equally effective alternative for it. Examples are reliance on credit reports or use of debt-to-income ratio in a way that appears consistent with industry standards and with a prudent evaluation of credit risk.

### Conditions

1. A specific policy or criterion is involved.

The policy or criterion suspected of producing a disproportionate adverse impact on a prohibited basis should be clear enough that the nature of action to correct the situation can be determined.

NOTE: Gross HMDA denial or approval rate disparities are not appropriate for disproportionate adverse impact analysis because they typically cannot be attributed to a specific policy or criterion.

2. The policy or criterion on its stated terms is neutral for prohibited bases.
3. The policy or criterion falls disproportionately on applicants or borrowers in a prohibited basis group.

The difference between the rate at which prohibited basis group members are harmed or excluded by the policy or criterion and the rate for control group members must be large enough that it is unlikely that it could have occurred by chance. If there is reason to suspect a significant disproportionate adverse impact may exist, consult with agency supervisory staff as appropriate.

4. There is a causal relationship between the policy or criterion and the adverse result.

The link between the policy or criterion and the harmful or exclusionary effect must not be speculative. It must be clear that changing or terminating the policy or criterion would reduce the disproportion in the adverse result.

5. Either a or b:
  - a. The policy or criterion has no clear rationale, or appears to exist merely for convenience or to avoid a minimal expense, or is far removed from common sense or standard industry underwriting considerations or lending practices.

The legal doctrine of disproportionate adverse impact provides that the policy or criterion that causes the impact must be justified by "business necessity" if the institution is to avoid a violation. There is very little authoritative legal interpretation of that term with regard to lending, but that should not stop examiners from making the preliminary inquiries called for in these procedures. For example, the rationale is generally not clear for basing credit decisions on factors such as location of residence, income level (*per se* rather than relative to debt), and accounts with a finance company. If prohibited basis group applicants were denied loans more frequently than control group applicants because they failed an institution's minimum income requirement, it would appear that the

first four conditions plus 5a existed; therefore, the examiners should consult within their agency about obtaining the institution's response, as described in the next section below.

- b. Alternatively, even if there is a sound justification for the policy, it appears that there may be an equally effective alternative for accomplishing the same objective with a smaller disproportionate adverse impact.

The law does not require an institution to abandon a policy or criterion that is clearly the most effective method of accomplishing a legitimate business objective. However, if an alternative that is approximately equally effective is available that would cause a less severe adverse impact, the policy or criterion in question may constitute a violation.

At any stage of the analysis of possible disproportionate adverse impact, if there appears to be such an alternative, and the first four conditions exist, consult within the agency how to evaluate whether the alternative would be equally effective and would cause a less-severe impact. If the conclusion is that it would, solicit a response from the institution, as described in the next section below.

## Obtaining the Institution's Response

If the first four conditions plus either 5a or 5b appear to exist, consult with agency supervisory staff about whether and how to inform the institution of the situation and solicit the institution's response. The communication with the institution may include the following:

- The specific neutral policy or criterion that appears to cause a disproportionate adverse impact.
- How the examiners learned about the policy.
- How widely the examiners understand it to be implemented.
- How strictly they understand it to be applied.
- The prohibited basis on which the impact occurs.
- The magnitude of the impact.
- The nature of the injury to individuals.
- The data from which the impact was computed.

The communication should request that the institution provide any information supporting the business justification for the policy and request that the institution describe any alternatives it consid-

ered before adopting the policy or criterion at issue.

## Evaluating and Following Up on the Response

The analyses of "business necessity" and "less discriminatory alternative" tend to converge because of the close relationship of the questions of what purpose the policy or criterion serves and whether it is the most effective means to accomplish that purpose.

Evaluate whether the institution's response persuasively contradicts the existence of the significant disparity or establishes a business justification. Consult with agency supervisory staff, as appropriate.

## B. Discriminatory Pre-Application Screening

Obtain an explanation for any:

- Withdrawals by applicants in prohibited basis groups without documentation of consumer intent to withdraw;
- Denials of applicants in prohibited basis groups without any documentation of applicant qualifications; or
- On a prohibited basis, selectively quoting unfavorable terms (for example, high fees or down payment requirements) to prospective applicants, or quoting unfavorable terms to all prospective applicants but waiving such terms for control group applicants. (Evidence of this might be found in withdrawn or incomplete files.)
- Obtain explanations for any delays between application and action dates on a prohibited basis

If the institution cannot explain the situations, examiners should consider obtaining authorization from their agency to contact the consumers to verify the institution's description of the transactions. Information from the consumer may help determine whether a violation occurred.

In some instances, such as possible "prescreening" of applicants by institution personnel, the results of the procedures discussed so far, including interviews with consumers, may be inconclusive in determining whether a violation has occurred. In those cases, examiners should, if authorized by their agency, consult with agency supervisory staff regarding the possible use of "testers" who would pose as apparently similarly situated applicants, differing only as to race or other applicable prohibited basis characteristic, to determine and compare how the institution treats

them in the application process.

## C. Possible Discriminatory Marketing

1. Obtain full documentation of the nature and extent, together with management's explanation, of any:
  - Prohibited basis limitations stated in advertisements;
  - Code words in advertisements that convey prohibited limitations; or
  - Advertising patterns or practices that a reasonable person would believe indicate prohibited basis consumers are less desirable or are only eligible for certain products.
2. Obtain full documentation as to the nature and extent, together with management's explanation, for any situation in which the institution, despite the availability of other options in the market:
  - Advertises only in media serving either minority or non-minority areas of the market;
  - Markets through brokers or other agents that the institution knows, or could reasonably be expected to know, to serve only one racial or ethnic group in the market; or
  - Utilizes mailing or other distribution lists or other marketing techniques for pre-screened or other offerings of residential loan products that:
    - Explicitly exclude groups of prospective borrowers on a prohibited basis; or
    - Exclude geographies (e.g., census tracts, ZIP codes, etc.) within the institution's marketing area that have demonstrably higher percentages of minority group residents than does the remainder of the marketing area, but which have income and other credit-related characteristics similar to the geographies that were targeted for marketing; or
    - Offer different products to such geographies, especially if sub-prime products are primarily marketed to racial or ethnic minorities.

NOTE: Pre-screened solicitation of potential applicants on a prohibited basis does not violate ECOA. Such solicitations are, however, covered by the FHAct. Consequently, analyses of this form of potential marketing discrimination should be limited to residential loan products.
3. Evaluate management's response particularly with regard to the credibility of any nondiscriminatory reasons offered as explanations for any

of the foregoing practices. Refer to *Evaluating Responses to Evidence of Disparate Treatment* elsewhere in this Appendix for guidance.

## USING SELF-TESTS AND SELF-EVALUATIONS TO STREAMLINE THE EXAMINATION

Institutions may find it advantageous to conduct self-tests or self-evaluations to measure or monitor their compliance with ECOA and Regulation B. A self-test is a program, practice or study that is designed and specifically used to assess the institution's compliance with fair lending laws that creates data not available or derived from loan, application or other records related to credit transactions (12 CFR 202.15(b)(1) and 24 CFR 100.140–100.148). For example, using testers to determine whether there is disparate treatment in the pre-application stage of credit shopping may constitute a self-test. The information set forth in 12 CFR 202.15(b)(2) and 24 CFR 100.142(a) is privileged unless an institution voluntarily discloses the report or results or otherwise forfeits the privilege. A self-evaluation, while generally having the same purpose as a self-test, does not create any new data or factual information, but uses data readily available in loan or application files and other records used in credit transactions and, therefore, does not meet the self-test definition.

Examiners should not request any information privileged under 12 CFR 202.15(b)(2) and 24 CFR 100.142(a), related to self-tests. If the institution discloses the results of any self-tests, or has performed any self-evaluations, and examiners can confirm the reliability and appropriateness of the self-tests or self-evaluations (or even parts of them), they need not repeat those tasks.

NOTE: When the term self-evaluation is used below, it is meant to include self-tests where the institution has voluntarily disclosed the report or results.

If the institution has performed a self-evaluation of any of the product(s) selected for examination, obtain a copy thereof and proceed through the remaining steps of this section on Streamlining the Examination.

Determine whether the research and analysis of the planned examination would duplicate the institution's own efforts. If the answers to Questions A and B below are both Yes, each successive Yes answer to Questions C through L indicates that the institution's work up to that point can serve as a basis for eliminating examination steps.

If the answer to either Question A or B is No, the self-evaluation cannot serve as a basis for eliminating examination steps. However, examiners should

still consider the self-evaluation to the degree possible in light of the remaining questions and communicate the findings to the institution so that it can improve its self-evaluation process.

- A. Did the transactions covered by the self-evaluation occur not longer ago than two years prior to the examination? If the self-evaluation covered more than two years prior to the examination incorporate only results from transactions in the most recent two years.
- B. Did it cover the same product, prohibited basis, decision center, and stage of the lending process (for example, underwriting, setting of loan terms) as the planned examination?
- C. Did the self-evaluation include comparative file review?  
NOTE: One type of "comparative file review" is statistical modeling to determine whether similar control group and prohibited basis group applicants were treated similarly. If an institution offers self-evaluation results based on a statistical model, consult appropriately within your agency.
- D. Were control and prohibited basis groups defined accurately and consistently with ECOA and/or the FHAct?
- E. Were the transactions selected for the self-evaluation chosen so as to focus on marginal applicants or, in the alternative, selected randomly?
- F. Were the data analyzed (whether abstracted from files or obtained from electronic databases) accurate? Were those data actually relied on by the credit decision makers at the time of the decisions?

To answer these two questions and Question G below, for the institution's control group sample and each of its prohibited basis group samples, request to review 10% (but not more than 50 for each group) of the transactions covered by the self-evaluation. For example, if the institution's self-evaluation reviewed 250 control group and 75 prohibited basis group transactions, plan to verify the data for 25 control group and seven prohibited basis group transactions.

- G. Did the 10% sample reviewed for Question F also show that customer assistance and institution judgment that assisted or enabled applicants to qualify were recorded systematically and accurately and were compared for differences on any prohibited bases?
- H. Were prohibited basis group applicants' qualifications related to the underwriting factor in question compared to corresponding qualifications of control group approvals? Specifically,

for self-evaluations of approve/deny decisions, were the denied applicants' qualifications related to the stated reason for denial compared to the corresponding qualifications for approved applicants?

- I. Did the self-evaluation sample cover at least as many transactions at the initial stage of review as examiners would initially have reviewed using the sampling guidance in these procedures?

If the institution's samples are significantly smaller than those in the sampling guidance but its methodology otherwise is sound, review additional transactions until the numbers of reviewed control group and prohibited basis group transactions equal the minimums for the initial stage of review in the sampling guidance.

- J. Did the self-evaluation identify instances in which prohibited basis group applicants were treated less favorably than control group applicants who were no better qualified?
- K. Were explanations solicited for such instances from the persons responsible for the decisions?
- L. Were the reasons cited by credit decision makers to justify or explain instances of appar-

ent disparate treatment supported by legitimate, persuasive facts or reasoning?

If the questions above are answered "Yes", incorporate the findings of the self-evaluation (whether supporting compliance or violations) into the examination findings. Indicate that those findings are based on verified data from the institution's self-evaluation. In addition, consult appropriately within the agency regarding whether or not to conduct corroborative file analyses in addition to those performed by the institution.

If not all of the questions in the section above are answered "Yes", resume the examination procedures at the point where the institution's reliable work would not be duplicated. In other words, use the reliable portion of the self-evaluation and correspondingly reduce independent comparative file review by examiners. For example, if the institution conducted a comparative file review that compared applicants' qualifications without taking account of the reasons they were denied, the examiners could use the qualification data abstracted by the institution (if accurate) but would have to construct independent comparisons structured around the reasons for denial.

# Federal Fair Lending Regulations and Statutes

## Alternative Examination Approach for Low-Risk Banks

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The alternative approach to fair lending examinations is designed for banks found during the fair lending scoping process to be at low risk of discriminatory practices. These low-risk banks typically are stable community banks located in suburban or rural areas that have a very low proportion of minority residents; they often are predominantly commercial or agricultural lenders that offer standard loan products and may lack sufficient prohibited-basis denials to conduct an underwriting analysis. These banks also tend to have stable staffing, no significant changes in bank policy and procedures since the most recent examination, and no history of fair lending concerns.

Use of this alternative examination approach should help validate the conclusions reached during the scoping process and should reduce the number of resources devoted to examinations of banks whose risk level clearly is not high enough to warrant extensive comparative analysis.

Successful use of this alternative examination approach depends on the integrity of the scoping process. As a result, it is important that all relevant areas of credit operations, including commercial and agricultural lending, are considered during the scoping process. If no risk factors are identified during scoping, examiners should proceed with the following steps:

1. Select a judgmental sample of loans for review to test how the lending criteria are actually applied. The sample should be representative of the major product lines of the institution and should include denials as well as approvals that were processed in the preceding twelve months.
2. Review the transactions to determine if they were underwritten according to the bank's articulated lending criteria. The transactions should not, therefore, be compared with each other, as they are in a benchmark or overlap analysis. Deviations in underwriting should be investigated and documented. This review will

verify actual underwriting practices and may result in the identification of risk factors.

3. Use the same sample to review the bank's pricing practices (it may be necessary to add a few more approvals to take the place of the denials in the original sample). Loan pricing should be compared with the bank's pricing methodology that was described to examiners during the scoping process. The transactions should not be compared with each other, as is the practice for the terms-and-conditions analysis. Pricing deviations should be investigated and documented. This review will verify actual pricing practices and may result in the identification of risk factors.
4. If no risk factors are identified using these alternative procedures, then the low-risk conclusion drawn in the scoping process is validated. At this point, the discrimination analysis is complete.
5. If risk factors are identified through either the underwriting or the pricing review, a focal point should be established and the sample expanded for that particular product line to do a full analysis using either a benchmark or overlap analysis or the terms-and-conditions examination procedures. Sample sizes should correspond to those in the sample size tables in the appendix to the examination procedures and should be focused on marginal applicants.
6. The fair lending scoping for the next examination should not assume that the bank remains low-risk. The scoping process should make a new determination of the risk level of the bank.

The fair lending scope memo should document the reasons the bank was determined to be low-risk. The fair lending section of the Report of Examination should state that the alternative examination approach was used because the bank exhibited low discrimination risk. Any appropriate comments about the bank's underwriting or pricing practices should be included.





# Regulation BB

## Community Reinvestment

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### Background and Summary

The Community Reinvestment Act (CRA) of 1977 (12 USC 2901), as amended, encourages each insured depository institution covered by the act to help meet the credit needs of the communities in which it operates. The CRA requires that each federal financial supervisory agency assess the record of each covered depository institution in helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operations; an agency will take that record into account when deciding whether to approve an institution's application for a deposit facility. The CRA has undergone numerous changes since its inception in 1977. In August 2005, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (the agencies) jointly adopted significant amendments to the CRA.

Neither the CRA nor its implementing regulations inject hard and fast rules or ratios into the examination or application processes. Rather, the law seeks to evaluate each lender's record while accommodating a lender's individual circumstances. Neither the CRA nor its implementing regulations require financial institutions to make high-risk loans that jeopardize their safety. To the contrary, the law makes it clear that an institution's lending to meet its CRA responsibilities should be conducted within the bounds of safety and soundness. Rebuilding and revitalizing communities through sound lending and good business judgment should benefit both communities and financial institutions.

An institution's capacity to help meet community credit needs is influenced by many factors, including its financial condition and size, constraints on its resources, legal impediments, and local economic conditions that could affect the demand and supply of credit. Examiners must consider these factors when evaluating an institution's performance under CRA. This approach is consistent with a fundamental underpinning of the CRA regulations—that the differences in institutions and the communities in which they do business preclude rigid and inflexible rules. Clear, flexible, and sensible performance criteria that accommodate differences in institutions and their communities, that minimize burden, that promote consistency and objectivity, and that allow examiners to be guided by common sense rather than adherence to

mechanistic procedures are embodied in the CRA regulations and the examination procedures that help to implement them.

For example, the CRA regulations provide different evaluation methods in response to basic differences in institutions' structures and operations. The regulations provide (1) a streamlined assessment method for small institutions that emphasizes lending performance; (2) an assessment method for intermediate small institutions that uses the same lending test used in the small-institution examination method, as well as a flexible community development test; (3) an assessment method for large retail institutions that focuses on lending, investment, and service performance; and (4) an assessment method for wholesale and limited-purpose institutions that is based on community development activities. Further, the regulations give any institution, regardless of its size or business strategy, the choice to be evaluated under a strategic plan. This type of flexibility and customizing should permit institutions to be evaluated fairly and in conformance with their business approach.

### Examination-Burden Reduction

The complementary regulatory themes of flexibility, responsiveness, and objectivity are extended to the examination process as part of an overarching effort to, among other things, reduce the burden of the regulations and the CRA examination on institutions. Indeed, both the regulations and the examination procedures reflect a conscientious effort to minimize the burden on financial institutions. For example, the agencies' conscious attempt to minimize the burden on supervised institutions can be seen in the fact that examiners are encouraged to draw on the results of previous examinations of an institution for information about its major product lines, business strategy, and supervisory restrictions. This information is typically available from agency sources and can often be reviewed off-site. Further, examiners may already have knowledge of an institution's community and local demographics from their own past visits to the institution or to other institutions in the same area. In these cases, examiners should be able to develop a good understanding of the context in which an institution operates before the actual examination begins. Examiners can then supplement and update that understanding upon arrival at the institution. Lastly, it should be noted that there are

no CRA data-reporting obligations for small institutions.

Similarly, the regulations focus on performance-based criteria, not on an institution's processes or documentation alone. Institutions are not to be evaluated on how well they ascertain community credit needs, how well they market and advertise their products, or how actively members of their boards of directors participate in local community organizations or civic groups.

This performance-based focus sets the stage for a constructive, credible, efficient, and unobtrusive examination process that concentrates on results. Both the regulations and the examination procedures promote and establish evaluation methods that are based on reviewing objective data; institutions can also use these methods to measure their own performance. Because examination results are more understandable and more predictable under these performance-based examination procedures, the burden on financial institutions is further minimized.

Rather than a one-size-fits-all examination, separate procedures have been developed for small, intermediate small, and large institutions, as well as for wholesale or limited-purpose institutions and institutions that are operating under an approved strategic plan. Further, examiners are expected to use their common sense to tailor an examination to a particular institution, thereby mitigating the burden on the institution. For example, examiners may be able to perform some procedures in advance of the on-site examination. This tailoring allows examiners to take reasonable steps to reduce the burden on an institution and ensure that the examination process is more understandable for the institution.

## Performance Context

An institution's performance under the regulatory assessment criteria is evaluated in the context of information about the institution, its community, and its competitors. The examiner will review demographic and economic data about the institution's assessment area(s), in addition to information about local economic conditions; the institution's major business products and strategies; and its financial condition, capacity, and ability to lend or invest in its community. Often, this review will be facilitated by gathering information from examinations of other institutions serving the same or similar assessment areas, reviewing information from other recent community contacts, and reviewing information about the assessment area developed cooperatively by the different agencies.

The examiner will also review information an institution chooses to provide about the lending,

investment, and service opportunities in its assessment area(s). The examiner will not, however, require the institution to create such information, nor will the examiner ask for any information other than what the institution may already have developed as part of its normal business practice. An examiner should not evaluate an institution on its efforts to ascertain community credit needs, market its products, geocode its loans, or record CRA-related discussions in its board minutes; an institution should also not be rated on the basis of the quality of any contextual information that it may provide.

## Role of Community Contacts

Interviews with local community, civic, or government leaders can help examiners learn about the community and its economic base, as well as local community development needs and initiatives. Interviews can also help examiners understand public perceptions about how well local institutions are responding to the community's credit needs. An examiner can use information obtained from these interviews to balance his or her understanding of the institution's performance context. Community contact interviews normally take the form of personal meetings, but telephone conversations or larger group meetings may also be appropriate.

Information from community contacts can provide valuable insights to examiners, particularly to those who have relatively little experience or familiarity with an institution's assessment area. Contacts may be made during an examination or prior to the start of an examination. Typically, the examiners responsible for the CRA examination will conduct the interviews. However, whenever possible, the agencies will draw on recent local interviews conducted by other agency staff or by other regulatory agencies that have CRA responsibilities in the area.

## Assessment-Area Considerations

Institutions are required to identify one or more assessment areas within which the agencies will evaluate the institution's performance. In most cases, an institution's assessment area will be the town, the municipality, the county, or some other political subdivision or the metropolitan statistical area (MSA) in which its branches are located and a substantial portion of its loans are made. If an institution chooses, however, its assessment area need not coincide with the boundaries of one or more political subdivisions (e.g., counties, cities, and towns or MSAs), so long as the adjustments to those boundaries reflect the fact that the institution's assessment area(s) would otherwise be too

large for the institution to serve, have an unusual configuration, or include significant geographic barriers. When the assessment area coincides with recognized political subdivisions, or when it has not changed in any way since the previous examination, examiners may not have to conduct a comprehensive reevaluation of the assessment area.

When evaluating an institution's performance, the examiner will use the assessment area designated by an institution, provided the assessment area meets regulatory criteria. Only if the criteria have not been satisfied will the examiner revise the assessment area so that it complies with the regulations. The revisions will be discussed with institution management, and the revised assessment area will be used to evaluate performance. However, unless the assessment area reflects illegal discrimination, examiners will not consider problems with the designation of the assessment area when assigning a rating to the institution.

### Performance Criteria for Small Institutions

Often, the burden of regulations and examinations is most pronounced in small institutions. Their limited financial resources and staffing, in addition to other competitive factors, may influence the way that small institutions meet their CRA responsibilities. In recognition of these factors, the regulations established a streamlined assessment method for small institutions that significantly reduces examination burden. The regulations contain only five performance criteria for small institutions:

1. The institution's loan-to-deposit ratio, adjusted for seasonal variation, and, as appropriate, other lending-related activities, such as loan originations for sale to the secondary markets, community development loans, or qualified investments
2. The percentage of loans and, as appropriate, other lending-related activities located in the institution's assessment area(s)
3. The institution's record of lending to and, as appropriate, engaging in other lending-related activities for borrowers of different income levels and businesses and farms of different sizes
4. The geographic distribution of the institution's loans
5. The institution's record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in its assessment area(s)

In carrying out their examination responsibilities, examiners should exercise common sense when deciding how much material to review and what steps are necessary to reach an accurate and

well-supported conclusion. For example, if an institution's assessment area is composed of only a few geographies, a geographic analysis of loans within the assessment area may be inappropriate or unnecessary. Or, if an institution has analyzed where and to whom it is making loans in its assessment area as part of its business efforts, examiners may be able to validate and then use the institution's analysis rather than conduct a detailed analysis of their own. In other words, when evaluating the performance criteria, examiners should always consider and use available, reliable information.

Similarly, if an institution's loan-to-deposit ratio appears low, the examination procedures ask the examiner to evaluate the institution's lending-related activities, such as loan sales and community development lending and investments, to determine if they materially supplement its lending performance as reflected in its loan-to-deposit ratio. However, such an analysis may not be necessary, or a less extensive analysis may be sufficient if the loan-to-deposit ratio is high.

### Performance Criteria for Intermediate Small Institutions

Intermediate small institutions are evaluated under two component tests: the small-institution lending test and the flexible community development test for intermediate small institutions. The lending test encompasses the same five performance criteria used for small institutions:

1. The institution's loan-to-deposit ratio, adjusted for seasonal variation, and, as appropriate, other lending-related activities, such as loan originations for sale to the secondary markets, community development loans, or qualified investments
2. The percentage of loans and, as appropriate, other lending-related activities located in the institution's assessment area(s)
3. The institution's record of lending to and, as appropriate, engaging in other lending-related activities for borrowers of different income levels and businesses and farms of different sizes
4. The geographic distribution of the institution's loans
5. The institution's record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in its assessment area(s)

The second component test for intermediate small institutions is the community development test that was created as a result of the 2005 regulatory changes. The intermediate-small-institution community development test considers the following four criteria:

1. The number and amount of community development loans
2. The number and amount of qualified investments
3. The extent to which the institution provides community development services
4. The institution's responsiveness through such activities to community development lending, investment, and services needs

Under the community development test, intermediate small institutions will be evaluated on their record of providing community development loans, qualified investments, and community development services under one single component rating, unlike the large-institution evaluation method, which considers and evaluates these three activities separately. Intermediate small institutions are expected to allocate resources among the different categories of community development loans, qualified investments, and community development services that are the most responsive to the community development needs and opportunities in the area. Although the agencies expect intermediate small institutions to generally engage in a combination of community development loans, qualified investments, and community development services, the appropriate levels of these activities are very institution-specific and will be determined by an institution's capacity and business strategy, as well as by the community development needs and opportunities in the area.

As they do when conducting other examination procedures, examiners should exercise judgment and common sense to minimize the burden imposed on an institution by the examination process. However, examiner judgment must be consistent with obtaining a complete and accurate assessment of an institution's performance. For example, examiners may be able to use economic and demographic data that were analyzed in an examination of one institution when they examine other institutions serving the same or similar assessment areas. Information from community contacts may cover more than one institution in a given market. When an institution has analyzed its CRA performance, examiners may use those analyses, after verifying their accuracy and reliability, and should supplement those analyses when questions are raised. Examiners should consider any performance-related information offered by an institution but should not request information not called for by examination procedures.

## Performance Criteria for Large Institutions

Large institutions are evaluated and rated under three separate performance tests: the lending test,

the investment test, and the service test.

### Lending Test

The lending test evaluates a large institution's retail lending, as well as its community development lending, using five performance criteria:

1. The number and dollar amount of the institution's home mortgage, small business, small farm, and consumer loans, if applicable, in the institution's assessment area(s)
2. The geographic distribution of the institution's home mortgage, small business, small farm, and consumer loans, if applicable, based on the loan location
3. The distribution of the institution's home mortgage, small business, small farm, and consumer loans, if applicable, to borrowers of different income levels and businesses and farms of different sizes
4. The number and dollar amount of community development loans and their complexity and innovativeness
5. The institution's use of innovative and flexible lending practices

### Investment Test

The investment test evaluates an institution's record of making qualified investments, using the following four performance criteria:

1. The dollar amount of qualified investments
2. The innovativeness or complexity of qualified investments
3. The responsiveness of qualified investments to credit and community development needs
4. The degree to which the qualified investments are not routinely provided by private investors

### Service Test

The service test evaluates an institution's use of retail and community development services to meet the needs of the assessment area. The institution's retail services are evaluated in the retail service test, which includes four performance criteria:

1. The current distribution of the institution's branches among low-, moderate-, middle- and upper-income geographies
2. The institution's record of opening and closing branches, particularly branches located in low- or moderate-income geographies or primarily serving low- or moderate-income individuals
3. The availability and effectiveness of the institution's alternative systems for delivering services to low- and moderate-income areas and individuals

4. The range of services provided in low-, moderate-, middle-, and upper-income geographies and the degree to which the services are tailored to meet the needs of those geographies

An institution's community development services are considered using the two performance criteria in the community development service test:

1. The extent to which the institution provides community development services
2. The innovativeness and responsiveness of community development services

As mentioned previously under the small-institution and intermediate-small-institution examination procedures, examiners are expected to exercise judgment and common sense to minimize the burden of the examination process, consistent with obtaining a complete and accurate assessment of performance. However, large institutions face burdens that small institutions do not, particularly the burden of data collection and reporting. Nevertheless, because large-institution data exist in an automated form, examiners can conduct much of their necessary analysis before the on-site examination—thereby reducing disruptions caused by the presence of examiners at the institution. As they do in small institutions, examiners must be sensitive to the burden of the examination process and use their judgment and common sense to determine what examination steps are necessary to arrive at an accurate assessment of an institution's performance.

## Performance Criteria for Wholesale or Limited-Purpose Institutions

To be evaluated under the community development test, an institution must be designated as a wholesale or limited-purpose institution. An institution receives this designation by submitting a written request to its primary regulator. Once an institution has received a designation, it will not normally have to reapply for it. The designation will remain in effect until the institution requests that it be revoked or until one year after the agency determines that the institution no longer satisfies the criteria for designation and notifies the institution of this determination.

Wholesale or limited-purpose institutions are evaluated on the basis of their

1. Community development lending, qualified investments, or community development services;
2. Use of innovative or complex qualified investments, community development loans, or community development services and the extent to which investments are not routinely provided by private investors; and

3. Responsiveness to community credit and development needs.

Examiners must be cognizant of the context within which a wholesale or limited-purpose institution operates. Examiners should recognize that these institutions may tailor their community development activities on the basis of their own circumstances and the community development opportunities available to them in their assessment areas or in the broader statewide or regional areas that include the assessment areas.

Institutions need not engage in all three categories of community development activities to be considered Satisfactory under the community development test. Community development loans, investments, and services can be directed to a statewide or regional market that includes the institution's assessment area; these activities still qualify for consideration under the community development test as benefiting the assessment area. Moreover, if an institution has a Satisfactory community development record in its assessment area, all community development activities regardless of their locations should be considered.

In applying the community development test, examiners should perform only those analyses that are necessary to reach an accurate conclusion about the institution's performance; use all available, reliable information; and avoid duplication of effort to reduce the examination burden on an institution.

## Strategic Plans

The regulations permit any institution to develop a strategic plan for addressing its CRA responsibilities. An institution must submit its strategic plan to its primary supervisory agency for approval. The regulations require that the plan be developed in consultation with members of the public and be published for public comment. The plan must contain measurable annual goals. A single plan may contain goals designed to achieve only a Satisfactory rating; at the institution's option, a plan may also contain goals designed to achieve a Satisfactory rating, as well as goals designed to achieve an Outstanding rating.

The strategic-plan approach to addressing an institution's CRA responsibilities presents an opportunity for a very straightforward examination. The first question an examiner should investigate is whether the goals were met. If they were, the appropriate rating should be assigned. The appropriateness of the goals will have already been determined during the public comment period for the plan and as part of the appropriate agency's review and approval of the plan. Consequently,

further investigation relating to the context of the institution should not be necessary. Obviously, if some or all of the plan's goals were not met, the examiner will be required to evaluate issues such as whether the goals were substantially met; in doing so, the examiner will have to exercise some judgment about the degree goals were missed and the causes.

However, an examiner should approach an examination of an institution operating under a strategic plan understanding the primary purpose of the regulatory provisions on strategic plans: to give an institution significant latitude to design a program that is appropriate to its own capabilities, business strategies, and organizational framework, as well as to the communities it serves. Consequently, the institution may develop plans for a single assessment area that it serves; for some, but not all, of the assessment areas that it serves; or for all of them. It may also develop a plan that incorporates and coordinates the activities of

various affiliates. The examiner's challenge is to evaluate institutions operating under one plan or under a number of plans in a way that accurately reflects the results achieved and that sensibly wraps that evaluation into the overall assessment of the institution.

Again, an examiner should, to the greatest extent possible, use information available from the agencies to evaluate an institution's performance under a strategic plan. However, it is likely that some elements of a plan under review will not be reflected in public or other agency data. Consequently, the examiner may, of necessity, have to ask the institution for the data necessary to determine whether it has met its goals. To the extent possible, the examiner should ask the institution to provide data for review before the on-site portion of the examination. The examiner should also seek to mitigate the burden on the institution by, wherever possible, using data in the form maintained by the institution.

# Small Institutions Examination Procedures and Sample Format for Public Disclosure of Examination Results

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The Examination Procedures for Small Institutions (which include the CRA Ratings Matrix for Small Institutions) and the Sample Format for Public Disclosure of Examination Results follow. Both documents are also available on the web site of the Federal Financial Institutions Examination Council.

Examination Procedures: [www.ffiec.gov/cra/pdf/cra\\_exsmall.pdf](http://www.ffiec.gov/cra/pdf/cra_exsmall.pdf)

Sample Format for Public Disclosure of Examination Results: [www.ffiec.gov/cra/pdf/ex\\_instruct\\_s.pdf](http://www.ffiec.gov/cra/pdf/ex_instruct_s.pdf)





# Small-Institution Performance Evaluations

## Interagency Guidance on Using the Streamlined Assessment Method

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*This guidance, issued on November 26, 1996, was adopted by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.*

This interagency guidance supplements the CRA examination procedures for small institutions. The guidance is designed to facilitate the proper use of the examination procedures and to promote consistency among the agencies in presenting examination findings.

Public evaluations should include efficient, substantive, and complete discussions of facts, data, and analysis that lead to conclusions about performance. The determination of the “reasonableness” of the loan-to-deposit ratio, the proportion of lending within an institution’s assessment area, or the geographic and borrower distribution of lending is clearly not a simple task. It is precisely this difficulty that places an increased importance upon the written explanation of the examiner’s analysis and conclusions, and prompts the issuance of this guidance.

### Description of the Assessment Area

#### Demographic Information

The interagency public evaluation format requires that the discussion of an institution’s assessment area include descriptive information regarding population, median income, employment, community credit needs, and business opportunities. Any information that was considered by the examiner in forming overall conclusions regarding the institution’s performance should be included in this description.

Information regarding the racial or ethnic composition of an assessment area should be included in the public evaluation only where a finding of racial discrimination impacted the institution’s performance. The CRA regulation focuses primarily on lending to borrowers and geographies of different income levels. An institution’s fair lending record affects its CRA record in cases where substantive violations of the fair lending laws are found. The inclusion of race and national origin data in each public evaluation, whether or not fair lending issues are present, may contribute to public confusion regarding the purpose of the Community Reinvestment Act as compared to the fair lending laws.

Assessment-area descriptions should include, however, information regarding the number and

percentage of low-, moderate-, middle-, and upper-income geographies and families within the assessment area since this information is always relevant to conclusions regarding an institution’s CRA performance. It may be useful to use tables indicating the percentage of geographies and families in each income category to convey this information clearly.

#### Assessment-Area Delineation

Regulation BB makes it clear that an institution’s ability to properly draw an assessment area is not a consideration in evaluating its performance. As a result, the public evaluation should not refer to the assessment area’s compliance with regulatory requirements. If the examiner finds that the assessment area does not comply with regulatory requirements, that fact should be noted in the report of examination. The public evaluation should be based on the appropriate (redrawn) assessment area.

#### Community Contacts

The description of the assessment area should also include information obtained from community contacts that the examiner used in forming conclusions about the institution’s performance. Community contacts provide insight that can help update, and lend perspective to, data gathered from other sources. These contacts are a very important part of the CRA examination. The public evaluation should note information from recent relevant contacts that were made in connection with the CRA examination being conducted, as well as in connection with other examinations, including those conducted by staff from other agencies.

Examiners should include as much information as possible about community contacts to give the reader of the public evaluation an understanding of the contact’s background and knowledge of the area. General statements that “several contacts” were made and the information was used in evaluating the institution’s performance are not adequately descriptive.

It is usually sufficient to identify the types of contacts made without indicating the name of the contact or the organization represented. A discussion of community contacts in the public evaluation might state, for example, “Two contacts were made during the examination. One contact was a representative from an organization that provides affordable housing to low-income residents in the county.

The other contact focused on small business development. Information from a community contact made by [another agency] with a governmental housing authority was also used in analyzing the institution's lending record.”

Information regarding comments made by community contacts should be included in the public evaluation, absent a request to the contrary by the person contacted. Those comments should be specific enough that the reader can understand how conclusions were reached later in the public evaluation, but not so specific as to identify the contact.

## Conclusions with Respect to Performance Criteria

### Facts, Data, and Analysis

As noted in the format for small-institution public evaluations, overall conclusions must address key aspects of an institution's CRA performance based upon an analysis of facts and data derived from the examination process. The public evaluation should be written in a way that allows the reader to understand how the examiner arrived at conclusions for each of the performance criteria. Comments in this section should explicitly relate facts and data regarding the institution's performance to the examiner's findings.

For example, the statement that “an institution makes virtually all of its loans in its assessment area” is not sufficient. If applicable, a better presentation of this conclusion would be “Examiners reviewed and verified the institution's internal analysis of credit extensions made during the examination period. A substantial majority of the institution's lending was conducted within its assessment area. The review included the institution's two major product lines, commercial and one- to four-family mortgage loans. The examination found that 94 percent of the commercial loans and 96 percent of the mortgage loans made by the institution were within its assessment area. By volume, 84 percent of commercial loans and 88 percent of mortgage loans made by the institution were inside its assessment area.”

Likewise, statements asserting that lending to low- and moderate-income individuals reflects the population within the assessment area without further explanation are not sufficiently informative. This type of a statement implies that the credit needs in this assessment area were proportional to the various income levels represented in the overall population. This is not, however, always true, necessary, or relevant. Perhaps, there were limited lending opportunities in one or more income categories. For instance, a mortgage lender may

be unable to tap the very low-income geographies because of a high number of rental properties. Alternatively, a consumer lender may be equally unable to make consumer credit available to high-income residents who prefer to take on second mortgages. To avoid this problem, public evaluations should include an analysis of performance that includes information from the materials used to develop the examiner's understanding of the performance context about loan demand in the various areas with income levels, as appropriate.

### Loan-to-Deposit Ratio

Discussions of the loan-to-deposit ratio in the public evaluations should reference the information that is used to support the conclusion that the ratio is or is not reasonable. This may, for instance, require a discussion of other similarly situated lenders in the assessment area under review or other support, as appropriate. If, for instance, an institution has a lower average loan-to-deposit ratio than other similarly situated lenders in its assessment area and the examiner finds this delineation “reasonable,” the discussion should distinguish the institution under review from the similarly situated lenders in the assessment area. Consulting recent examinations performed in the assessment areas may assist in this analysis.

It is important to remember that the loan-to-deposit ratio is a quick reference for determining whether an institution is lending. As such, it is not usually of central importance in the streamlined examination. Furthermore, by calling for an analysis of the adequacy of the loan-to-deposit ratio, the agencies do not intend to foster lending levels that might be considered unsafe or unsound. There is no fixed ratio that can be considered reasonable. Rather, loan-to-deposit ratios will vary depending on an institution's charter, its business strategy, the demographics of its assessment area, and other factors that make up the context in which the institution performs. There are occasions, however, where a loan-to-deposit ratio is so low that it becomes a central issue in the examination. For instance, where an institution makes very few loans during an examination cycle, the distribution of those loans is clearly not as relevant to the institution's performance rating as the fact that the institution may not be lending very much in any case.

### Origination

When analyzing an institution's lending performance, Regulation BB directs examiners to focus on loans originated since the last examination. To this end, the public evaluation should indicate the number and types of loans that were reviewed to

conduct the analysis. Applications and denials are generally not relevant to the analysis and, therefore, are not discussed in the examination procedures. A discussion of applications and denials may be appropriate, however, in a larger discussion of an institution's performance context. For instance, a discussion of applications and denials may be useful in explaining poor performance due to a lack of credit demand.

Activities that are in the planning stages that have not resulted in loan originations should not be considered in evaluating the institution's performance. This would include situations where an institution participates in a consortium developed to revitalize a downtown area but, at the time of the examination, has made no loans and the size of the loan pool has not yet been determined. In this example, there is no performance to evaluate during the examination period even though the activity would likely receive positive consideration once loans are made.

### Loans to Small Businesses and Small Farms

Where loans to small businesses and small farms are a major product line for the institution, it is important to analyze the distribution of lending to businesses or farms of different sizes. It is often difficult to determine the number of small businesses and farms using the statistical data gathered prior to the examination. Reliable data on the number of small businesses or farms in any given area is often scarce. Possible sources of information include local farm bureaus, extension agencies, and chambers of commerce. Supporting conclusions regarding the geographic or borrower distribution of small business and farm loans requires an analysis of the institution's small business and farm loans to businesses and farms of different sizes. This analysis is particularly important where the examination concludes that the institution exceeds the standards for Satisfactory performance.

### Geographic and Borrower Distribution

Examiners should refrain from including broad statements regarding the dispersion of loans throughout an assessment area without further discussing the adequacy of an institution's geographic distribution of lending at the income level. Dispersion is only one element of an analysis of geographic distribution. Specifically, a dispersion analysis is done to determine whether any significant gaps or lapses in lending are present in the institution's assessment area. The main focus of this analysis is the institution's geographic distribution of loans among low-, moderate-, middle-, and

upper-income geographies. The regulation and examination procedures specifically direct that the analysis be conducted with respect to each of the four income categories separately. Examiners may use an institution's internal analysis of geographic distribution after verifying its accuracy. If such an analysis is not available, a sample of loan files must be used to conduct a geographic distribution analysis.

Similarly, examiners may use an institution's internal analysis of its lending by borrower income, if available, after verifying its accuracy. If the institution has not prepared a reliable analysis, loan files should be sampled to analyze lending distribution by borrower income. If the information necessary to do a distribution analysis by borrower income is not available in loan files, the examiner may use other available information as a proxy for such information. Of course, any information used to reach conclusions regarding lending distribution by borrower income or geography must be discussed in the public evaluation.

Finally, there may be situations where an analysis of lending distribution by geography and borrower income appears to exceed standards for a Satisfactory rating but, upon closer analysis, the institution's overall lending activity is very low. For instance, if an institution has only made a dozen loans since its last examination, it would be very difficult to justify a conclusion that the distribution of its loans met the standards for a Satisfactory rating, even if each loan was in a low- or moderate-income area or to a low- or moderate-income individual.

Where there is insufficient information available to perform a meaningful geographic- or borrower-distribution analysis, examiners should type "analysis was not meaningful" across the appropriate rows of the performance evaluation grid. The discussion of the analysis should explain why the analysis could not be performed. For example, where an assessment area consists entirely of middle-income census tracts and the examiner has concluded that proxies that would enable a meaningful geographic analysis are not available, the public evaluation should state that fact.

### Elements Supporting an Outstanding Rating

A rating of Outstanding will normally be accompanied by an explanation that expressly considers not only a small institution's lending but also its performance in qualified investments and delivery of retail services. Although a small institution can receive an Outstanding rating based on the strength of its lending performance, the appendix to the CRA regulation makes it clear that in assessing whether an institution's performance is

Outstanding, the [agency] considers the extent to which the institution exceeds each of the performance standards for a Satisfactory rating and its performance in making qualified investments and its performance in providing branches and other services and delivery systems that enhance credit availability in its assessment area. Consequently, the examination procedures provide that a small institution can receive an Outstanding rating without a review of investments and services only when its lending performance is so exceptional that the examiner determines that a review of investments and services would not further improve the institution's performance level. In other words, the review of investments and services would be superfluous in the presence of what is already considered to be an Outstanding level of performance based on lending alone.

Note that an Outstanding institution is characterized not only by a high loan-to-deposit ratio and a high percentage of loans in its assessment area but also by an "excellent" penetration of borrowers at all income levels and an "excellent" dispersion of loans throughout geographies of different incomes in its assessment area.

The examination procedures recognize that institutions can exceed the standards for Satisfactory performance in varying degrees. In CRA (as in other rating systems), the Satisfactory category embraces a rather broad range of different performance levels. Some institutions that have strong lending records will end up with the same rating as other institutions that are marginally Satisfactory. Nevertheless, there is a difference between institutions rated Outstanding and those rated at the high end of the Satisfactory range.

An institution may exceed standards for Satisfactory performance in three ratable categories and still not merit an Outstanding. To receive an Outstanding on the strength of its lending performance, the institution must materially exceed the standards for Satisfactory in some or all of the criteria. The judgment that an institution materially exceeds Satisfactory standards and warrants an Outstanding rating should be based on largely indisputable evidence that an entire community is being served, including an excellent penetration of low and moderate borrowers and geographies within its assessment area(s). Remember that the Community Reinvestment Act specifically requires the agencies "to assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods." Application of the streamlined examination does not alter the policy focus of the overall evaluation. Serving the credit needs of low- and moderate-income borrowers and neighborhoods

should not get lost in the process of calculating loan-to-deposit ratios and "in-out" percentages.

While small institutions do not go through the same rigors as the large-institution examinations, small institutions are not intended to be unduly favored when it comes to assigning ratings for their performance. In addition to determining whether an institution has exceeded some or all of the standards for a Satisfactory rating, the agencies will consider a small institution's investment and service performance based on a broad range of investment and service activities. For example, the examination procedures permit an Outstanding rating if the institution's performance with respect to the five core criteria generally exceeds Satisfactory and its performance in making qualified investments and providing branches and other services and delivery systems in the assessment area(s) supplements its performance under the five core criteria sufficiently to warrant an overall rating of Outstanding.

## Additional Observations

### Information Regarding Process-Oriented Activities

Process-oriented activities, such as the internal monitoring of the geographic distribution of loans, needs ascertainment, marketing, and efforts to achieve CRA objectives, rarely substantiate strong performance or explain poor performance. These activities may, on occasion, be discussed to explain elements of the performance context that affect the institution.

### Consideration of Prior Ratings

The performance-context procedures require examiners to consider the prior performance rating, among other factors, when evaluating the institution. The prior rating is of interest to the public and should be considered in assessing current performance.

### Fair Lending

The fair lending portion of the compliance examination is the appropriate medium for analyzing an institution's performance with respect to making credit decisions in compliance with the Equal Credit Opportunity Act and the Fair Housing Act. Findings of discrimination on a prohibited basis, however, should be discussed in the CRA and examination report in accordance with the guidance provided in the sample Public Evaluation.

# Small-Institution Performance Evaluations

## Instructions for Sampling at Small Institutions

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*These instructions were distributed as attachment B to CA 02-3 (January 24, 2002).*

Examiners are required to estimate three proportions in connection with examinations of small institutions: the proportion of loans inside and outside of an assessment area; the proportion of loans in low-, moderate-, middle-, and upper-income geographies in an assessment area; and the proportion of loans to low-, moderate-, middle-, and upper-income borrowers within an assessment area. Examiners are to interpret the estimated proportions based on the performance context and other information obtained during the examination.

Under the revised regulation, small banks are not required to collect data for CRA examination purposes. However, some small institutions may choose to provide data regarding their loans, including the census-tract locations and borrower incomes, similar to those being required for large institutions. Some institutions may even provide a summary of their distribution of loans. In this case, as long as the examiner is able to verify the bank's information using the guidance provided with respect to sampling with data accuracy in CA 01-8, the examiner will not need to perform sampling to evaluate the bank's CRA performance but may use the data supplied by the bank.

### Step 1

Examiners should select samples for one or more major product lines, taking into account factors such as the institution's business strategy and its areas of expertise. As an initial matter, it will be acceptable to select for review for these purposes among the same categories of loans that are to be used when reviewing large banks, i.e. mortgages, small business and farm loans, and consumer loans.<sup>1</sup>

### Step 2

The total number of loans, both originated and purchased by the institution, for a major product category will be defined as the "universe" of loans. In order to determine the number of loans for the sample (known as the sample size), examiners should know the number of loans in the universe, even if this requires them to count the number of loans manually.

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1. According to Regulation BB, the major consumer product categories are defined as home equity, motor vehicle, other secured, other unsecured, and credit card.

This universe can include

- The total number of loans since the last examination, or
- The total number of loans in the previous year, or
- The total number of loans in the previous six months.

The universe of loans should cover at least the activity in the six months prior to the examination. It should cover at least the prior year if the number of loans made in the last six months is less than 50. If the universe of loans for the previous year for any particular product category is less than 50, then all loans made or purchased since the last examination for that product should be included in the universe. Moreover, when selecting the universe, examiners should ensure that loans included in the universe are representative of the bank's loan activity during the entire examination period.

### Step 3

The examiner should determine the number of loans to be sampled. Use the sampling software to determine the appropriate number of loans to be selected for each product category being examined. The software computes the sample size based on the universe of loans for each product and the desired confidence and precision levels.

Initially, examiners should select samples based on a 90 percent confidence interval, with a plus or minus 5 percent level of precision. This means that there is a 90 percent chance that the results from the sample will be within 5 percent of the true proportion, for whichever criteria are being evaluated. This confidence interval was chosen because it should ensure an acceptable reliability of results. However, examination reports for small banks should be monitored closely during the first year of experience with this new sampling approach so that a review of the results of implementing this policy can be done when there has been adequate field experience. For loan products or institutions that require further investigation or are undergoing greater scrutiny for any reason, a 95 percent confidence level with plus or minus 5 percent precision should be used. A more stringent statistical framework using a higher confidence level is necessary because in these cases examiners will need results with a higher degree of reliability.

### How to Select a Random Sample

Once the number of loans to be sampled is known,

the examiners should select these loans from a list of loans unique to that product, if one is available from the bank. If no unique list or other sorting system is available for use, the examiner must restrict the random sampling procedures below to each product category that can be segregated.

To select files, the examiner should calculate the interval to use for sampling by dividing the number of loans in the universe by the number of loans in the sample and rounding up to the nearest whole number. For example, if there are 150 loans in the universe and 86 in the sample, the calculation is  $150/86=1.74$ , which, when rounded, is 2. The examiner should start by choosing either the first or second loan and then proceed through the list of 150 loans and select every other file. After the first pass through the list, the examiner would have selected 75 of the 86 needed for the sample. To select the 11 additional files, the examiner should follow the same process with the remaining files on the list. Dividing 75 (the remaining files not already selected for the sample) by 11 yields 6.82, which rounds up to 7. This time the examiner would start by selecting any of the first 7 loans on the list and then select every seventh file thereafter. This will add 10 to the sample. Having done this, 85 files will have been selected for the sample and 65 files not selected. Selecting 1 more file, at random, from the 65 not already selected, will complete the sample.

### Calculating Proportion Estimates and Resulting Reliability

The next step is to calculate the proportion estimates as itemized in the examination procedures. Once the loan data are entered, the software program will generate the following reports for examiner use:

#### *Comparisons of Credit Extended Inside and Outside of the Assessment Area<sup>2</sup>*

- The percentage of the number of loans (by product type) inside and outside the assessment area
- The percentage of the dollar amount of loans (by product type) inside and outside the assessment area

The results from the sample will be accompanied by a precision range (or confidence interval), plus or minus, around the estimate. For example, sampling for the percentage of loans (within a product type) outside of the assessment area may result in a proportion estimate of 32.5 percent with

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2. Sampling software will compute the proportion estimates for the examiner if they are available. Examiners will evaluate the results following the criteria outlined in the examination procedures.

a plus or minus 5 percent precision interval at the 90 percent confidence level. This means that there is a 90 percent probability that the percentage of the institution's loans of this type outside the assessment area is between 27.5 percent to 37.5 percent. The resulting precision interval is influenced by a range of factors, including the confidence level, and the incidence of missing data. In general, the narrower the range around the resulting estimate, the more accuracy that has been achieved from the sampling procedures.

#### *Distribution of Credit within the Assessment Area(s)<sup>3</sup>*

In accordance with the examination procedures, examiners should tabulate the following proportions based on *only those loan records from the sample that are within the assessment area* for each product category:

- The number and percentage of loan originations (by product type, if applicable) in low-, moderate-, middle-, and upper-income geographies
- The dollar amount and percentage of loan originations (by product type, if applicable) in low-, moderate-, middle-, and upper-income geographies
- The number and percentage of loan originations (by product type, if applicable) to low-, moderate-, middle-, and upper-income borrowers
- The dollar amount and percentage of loan originations (by product type, if applicable) in low-, moderate-, middle-, and upper-income borrowers
- The number and percentage of loan originations to small businesses/farms of different sizes (by revenue)
- The dollar amount and percentage of loan originations to small businesses/farms of different sizes (by revenue)

Examiners are to follow the guidelines in the examination procedures to interpret the results from the sampling and, ultimately, to assign a rating to the institution's lending performance. Note that the precision ranges for the distribution estimates may be broader than those for the "In/Out" analysis. This may be the case because the original sample size will have been reduced by those loans located *outside* the assessment area. Though it would be possible to augment the sample with additional loan records, this is not required in most cases because the time and expense involved do not seem justified by the greater precision of the results obtained. However, if the precision interval in such circumstances is more than 15 percent, the examiner should select, and enter, additional files

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3. Again, the sampling software will compute these results for examiners once the necessary data have been entered.

from within the assessment area in order to reduce the precision interval below 15 percent.

Examiners should take particular care in their interpretations of proportion estimates to low- or moderate-income geographies that are in the single digits. Even a high degree of precision in the sampling will not allow examiners to make fine distinctions when dealing with small proportion estimates. For example, if the total number of loan originations in a product line was 500 since the last examination and the sample results show a 2 percent penetration to low- and moderate-income

areas, then the resulting precision interval could be between .8 percent and 4.6 percent, using a 90 percent confidence level. Such a result does not allow the examiner to distinguish a .8 percent from a 4.0 percent penetration.

Examiners should also understand that the analytical reports do not identify specific tracts, or geographic "gaps," in a bank's lending. Therefore, while the software can be used to determine the distribution of loans made to different income geographies, examiners cannot rely on it to identify significant gaps in a bank's lending.





# Intermediate Small Institutions Examination Procedures and Sample Format for Public Disclosure of Examination Results

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The Examination Procedures for Intermediate Small Institutions and the Sample Format for Public Disclosure of Examination Results follow. Both documents are also available on the web site of the Federal Financial Institutions Examination Council.

Examination Procedures: [www.ffiec.gov/cra/pdf/isbank.pdf](http://www.ffiec.gov/cra/pdf/isbank.pdf)

Sample Format for Public Disclosure of Examination Results: [www.ffiec.gov/cra/pdf/ex\\_instruct\\_sinter.pdf](http://www.ffiec.gov/cra/pdf/ex_instruct_sinter.pdf)



# Large Institutions Examination Procedures and Sample Format for Public Disclosure of Examination Results

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The Examination Procedures for Large Institutions and the Sample Format for Public Disclosure of Examination Results follow. Both documents are also available on the web site of the Federal Financial Institutions Examination Council.

Examination Procedures: [www.ffiec.gov/cra/pdf/cra\\_exlarge9.pdf](http://www.ffiec.gov/cra/pdf/cra_exlarge9.pdf)

Sample Format for Public Disclosure of Examination Results: [www.ffiec.gov/cra/pdf/ex\\_instruct\\_l.pdf](http://www.ffiec.gov/cra/pdf/ex_instruct_l.pdf)



# Large Institutions Ratings Matrixes

## Lending-Test Matrix

Characteristic	Outstanding	High Satisfactory	Low Satisfactory	Needs to Improve	Substantial Noncompliance
Lending activity	Lending levels reflect excellent responsiveness to assessment-area credit needs.	Lending levels reflect good responsiveness to assessment-area credit needs.	Lending levels reflect adequate responsiveness to assessment-area credit needs.	Lending levels reflect poor responsiveness to assessment-area credit needs.	Lending levels reflect very poor responsiveness to assessment-area credit needs.
Assessment-area(s) concentration	A substantial majority of loans are made in the institution's assessment area(s).	A high percentage of loans are made in the institution's assessment area(s).	An adequate percentage of loans are made in the institution's assessment area(s).	A small percentage of loans are made in the institution's assessment area(s).	A very small percentage of loans are made in the institution's assessment area(s).
Geographic distributions of loans	The geographic distribution of loans reflects excellent penetration throughout the assessment area(s).	The geographic distribution of loans reflects good penetration throughout the assessment area(s).	The geographic distribution of loans reflects adequate penetration throughout the assessment area(s).	The geographic distribution of loans reflects poor penetration throughout the assessment area(s), particularly to low- or moderate-income geographies in the assessment area(s).	The geographic distribution of loans reflects very poor penetration throughout the assessment area(s), particularly to low- or moderate-income geographies in the assessment area(s).
Borrowers' profile	The distribution of borrowers reflects, given the product lines offered by the institution, excellent penetration among retail customers of different income levels and among business customers of different sizes.	The distribution of borrowers reflects, given the product lines offered by the institution, good penetration among retail customers of different income levels and among business customers of different sizes.	The distribution of borrowers reflects, given the product lines offered by the institution, adequate penetration among retail customers of different income levels and among business customers of different sizes.	The distribution of borrowers reflects, given the product lines offered by the institution, poor penetration among retail customers of different income levels and among business customers of different sizes.	The distribution of borrowers reflects, given the product lines offered by the institution, very poor penetration among retail customers of different income levels and among business customers of different sizes.

## Lending-Test Matrix—continued

Characteristic	Outstanding	High Satisfactory	Low Satisfactory	Needs to Improve	Substantial Noncompliance
Responsiveness to credit needs of highly economically disadvantaged geographies and to low-income persons and small business	The institution exhibits an excellent record of serving the credit needs of the most economically disadvantaged area(s) of its assessment area(s), low-income individuals, and/or very small businesses, consistent with safe and sound banking practices.	The institution exhibits a good record of serving the credit needs of the most economically disadvantaged area(s) of its assessment area(s), low-income individuals, and/or very small businesses, consistent with safe and sound banking practices.	The institution exhibits an adequate record of serving the credit needs of the most economically disadvantaged area(s) of its assessment area(s), low-income individuals, and/or very small businesses, consistent with safe and sound banking practices.	The institution exhibits a poor record of serving the credit needs of the most economically disadvantaged area(s) of its assessment area(s), low-income individuals, and/or very small businesses, consistent with safe and sound banking practices.	The institution exhibits a very poor record of serving the credit needs of the most economically disadvantaged area(s) of its assessment area(s), low-income individuals, and/or very small businesses, consistent with safe and sound banking practices.
Community development lending activities	The institution is a leader in making community development loans.	The institution has made a relatively high level of community development loans.	The institution has made an adequate level of community development loans.	The institution has made a low level of community development loans.	The institution has made few, if any, community development loans.
Product innovation	The institution makes extensive use of innovative and/or flexible lending practices in order to serve assessment-area credit needs.	The institution uses innovative and/or flexible lending practices in order to serve assessment-area credit needs.	The institution makes limited use of innovative and/or flexible lending practices in order to serve assessment-area credit needs.	The institution makes little use of innovative and/or flexible lending practices in order to serve assessment-area credit needs.	The institution makes no use of innovative and/or flexible lending practices in order to serve assessment-area credit needs.

## Investment-Test Matrix

Characteristic	Outstanding	High Satisfactory	Low Satisfactory	Needs to Improve	Substantial Noncompliance
Investment and grant activity	The institution has an excellent level of qualified community development investment and grants, often in a leadership position, particularly those that are not routinely provided by private investors.	The institution has a significant level of qualified community development investments and grants, occasionally in a leadership position, particularly those that are not routinely provided by private investors.	The institution has an adequate level of qualified community development investments and grants, although rarely in a leadership position, particularly those that are not routinely provided by private investors.	The institution has a poor level of qualified community development investments and grants, but not in a leadership position, particularly those that are not routinely provided by private investors.	The institution has a few, if any, qualified community development investments or grants, particularly those that are not routinely provided by private investors.
Responsiveness to credit and community development needs	The institution exhibits excellent responsiveness to credit and community economic development needs.	The institution exhibits good responsiveness to credit and community economic development needs.	The institution exhibits adequate responsiveness to credit and community economic development needs.	The institution exhibits poor responsiveness to credit and community economic development needs.	The institution exhibits very poor responsiveness to credit and community economic development needs.
Community development initiatives	The institution makes extensive use of innovative and/or complex investments to support community development initiatives.	The institution makes significant use of innovative and/or complex investments to support community development initiatives.	The institution occasionally uses innovative and/or complex investments to support community development initiatives.	The institution rarely uses innovative and/or complex investments to support community development initiatives.	The institution does not use innovative and/or complex investments to support community development initiatives.



## Service-Test Matrix

Characteristic	Outstanding	High Satisfactory	Low Satisfactory	Needs to Improve	Substantial Noncompliance
Accessibility of delivery systems	Delivery systems are readily accessible to all portions of the institution's assessment area(s).	Delivery systems are accessible to essentially all portions of the institution's assessment area(s).	Delivery systems are reasonably accessible to essentially all portions of the institution's assessment area(s).	Delivery systems are accessible to limited portions of the institution's assessment area(s).	Delivery systems are inaccessible to significant portions of the assessment area(s), particularly low- and moderate-income geographies and/or low- and moderate-income individuals.
Changes in branch locations	To the extent changes have been made, the institution's record of opening and closing branches has improved the accessibility of its delivery systems, particularly in low- and moderate-income geographies and/or to low- and moderate-income individuals.	To the extent changes have been made, the institution's opening and closing of branches has not adversely affected the accessibility of its delivery systems, particularly in low- and moderate-income geographies and/or to low- and moderate-income individuals.	To the extent changes have been made, the institution's opening and closing of branches has generally not adversely affected the accessibility of its delivery systems, particularly in low- and moderate-income geographies and/or to low- and moderate-income individuals.	To the extent changes have been made, the institution's record of opening and closing branches has adversely affected the accessibility of its delivery systems, particularly in low- and moderate-income geographies and/or to low- and moderate-income individuals.	To the extent changes have been made, the institution's opening and closing of branches has significantly adversely affected the accessibility of its delivery systems, particularly in low- and moderate-income geographies and/or to low- and moderate-income individuals.
Reasonableness of business hours and services in meeting assessment-area(s) needs	Services (including where appropriate, business hours) are tailored to the convenience and needs of the assessment area(s), particularly low- and moderate-income geographies and/or individuals.	Services (including, where appropriate, business hours) do not vary in a way that inconveniences certain portions of the assessment area(s), particularly low- and moderate-income geographies and/or individuals.	Services (including, where appropriate, business hours) do not vary in a way that inconveniences portions of the assessment area(s), particularly low- and moderate-income geographies and/or individuals.	Services (including, where appropriate, business hours) vary in a way that inconveniences certain portions of the assessment area(s), particularly low- and moderate-income geographies and/or individuals.	Services (including, where appropriate, business hours) vary in a way that significantly inconveniences many portions of the assessment area(s), particularly low- and moderate-income geographies and/or individuals.
Community development services	The institution is a leader in providing community development services.	The institution provides a relatively high level of community development services.	The institution provides an adequate level of community development services.	The institution provides a limited level of community development services.	The institution provides few, if any, community development services.

# Large Institutions Format Guidance for Public Disclosure of Examination Results

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This following guidance was transmitted in CA 02-7 (June 13, 2002). The guidance may be applied to the new large-bank performance evaluation templates transmitted in CA 05-7 (September 16, 2005).



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Large Institution Performance Evaluation  
September 2000

Federal Reserve Bank Guidance  
June 2002

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SAMPLE LARGE INSTITUTION EVALUATION

**PUBLIC DISCLOSURE**

(Date of Evaluation)

**COMMUNITY REINVESTMENT ACT  
PERFORMANCE EVALUATION**

Name of Depository Institution

Institution's Identification Number

Address of Institution

Name of Supervisory Agency

Address of Supervisory Agency

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

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### NOTE

This table of contents is a sample for a large, multistate institution, and should be adjusted, as appropriate, to reflect the scope of the institution’s operations. Refer to the Instructions for Writing Public Evaluations for further guidance.

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Large Institution Performance Evaluation  
September 2000

Federal Reserve Bank Guidance  
June 2002

## INSTITUTION'S RATING

*INSTITUTION'S CRA RATING: Name of financial institution is rated "[BOLDFACE CAPS]."*

*The following table indicates the performance level of name of financial institution with respect to the lending, investment, and service tests. [Indicate the performance level under each criteria by marking an "X" in the appropriate row.]*

PERFORMANCE LEVELS	NAME OF FINANCIAL INSTITUTION		
	PERFORMANCE TESTS		
	Lending Test*	Investment Test	Service Test
Outstanding			
High Satisfactory			
Low Satisfactory			
Needs to Improve			
Substantial Noncompliance			

\* The lending test is weighted more heavily than the investment and service tests in determining the overall rating.

Summarize the major factors supporting the institution's rating. When illegal discrimination or discouragement has been identified and has affected the rating, the summary should include a statement that the rating was influenced by violations of the substantive provisions of the antidiscrimination laws. The summary should not mention any technical violations of the antidiscrimination laws.

### NOTE

Present a bullet point **summary of the major factors supporting the institution's rating** with respect to each test.

## **INSTITUTION**

### **DESCRIPTION OF INSTITUTION**

Write a brief description of the institution. Include relevant information regarding the institution's holding company and affiliates, if any, the states and assessment areas served, the institution's ability to meet various credit needs based on its financial condition and size, product offerings, prior performance, legal impediments and other factors. Other information that may be important includes total assets, asset/loan portfolio mix, primary business focus, branching network, and any merger or acquisition activity.

#### **NOTE**

In addition to the above, remember: (1) When describing the bank's assessment areas, indicate if there has been any change in assessment areas since the prior examination. If so, explain the changes briefly with any necessary details. (2) A conclusion must be stated regarding the bank's ability to meet the various credit needs in its assessment areas but do not disclose confidential information, in accordance with the prohibition in 12 CFR 261.2(c)(1)(i). (3) You may include a map of the bank's assessment areas in an appendix.

## SCOPE OF EXAMINATION

### NOTE

Scope information orients the reader and, when presented here, eliminates repetition later in the document. At a minimum, the following items should be discussed: the specific lending products reviewed; the names of any affiliates reviewed and their corresponding lending, investment or service activities; the institution's assessment areas and whether its activities in the assessment areas were reviewed using the full examination procedures; and the period covered in the review. Indicate if any products or assessment areas were given greater weight in reaching conclusions. Indicate that the information presented here pertains throughout the evaluation unless specifically noted otherwise.

## CONCLUSIONS WITH RESPECT TO PERFORMANCE TESTS

Discuss the institution's overall CRA performance. The facts, data and analyses that were used to form a conclusion about the rating should be reflected in the narrative, including institution strengths and areas for improvement. The narrative should clearly demonstrate how the results of each of the performance test analyses and relevant information from the performance context factored into the overall institution rating. Charts and tables should be used whenever possible to summarize and effectively present the most critical or informative data used by the examiner in analyzing the institution's performance and reaching conclusions.

Write a paragraph about the institution's record of complying with the antidiscrimination laws (ECOA, FHA, or HMDA) using the following guidelines.

When substantive violations involving illegal discrimination or discouragement are found by the [Agency] or identified through self-assessment(s), state that substantive violations were found, whether they caused the CRA rating to be adjusted downward, and why the rating was or was not adjusted. Identify the law(s) and regulations(s) violated, the extent of the violation(s) (for example, widespread, or limited to a particular state, office, division, or subsidiary) and characterize management's responsiveness in acting upon the violation(s). Determine whether the institution has policies, procedures, training programs, internal assessment efforts, or other practices in place to prevent discriminatory or other illegal credit practices.

If no substantive violations were found, state that no violations of the substantive provisions of the antidiscrimination laws and regulations were identified. Even if discrimination has not been found, comments related to the institution's fair lending policies, procedures, training programs and internal assessment efforts may still be appropriate. If applicable, technical violations cited in the report of



examination should be presented in general terms. Discuss whether management has [proposed/taken] steps that [have/would if implemented] address(ed) the technical violation(s).

**NOTE**

Use the following format for the discussion:

**LENDING TEST**

State the rating (for example, “outstanding,” “high satisfactory,” “low satisfactory”) with respect to the lending test and provide a brief explanation to support the rating. This explanation should include the ratings of the states or conclusions about the full-scope MSAs, whichever is applicable, evaluated at the examination. Explain when any areas were given greater weight than others were.

**Lending Activity:** State the conclusion (for example, “excellent,” “good,” “adequate”) regarding lending activity. Use the Total Lending Activity Table below to show the total number and dollar value of all applicable loans originated or purchased by the bank and its affiliates. (Adjust table if consumer or other loan types are being evaluated.) If no affiliate lending is included, do not use the Total Lending Activity Table. Instead, refer to the combined totals from the Assessment Area Lending Table discussed below.

EXHIBIT 1  
**Summary of Lending Activity**

<b>Loan Type</b>	<b>#</b>	<b>%</b>	<b>\$(000s)</b>	<b>%</b>
HMDA home purchase	3,994	--	758,385	--
HMDA refinancings	2,081	--	399,258	--
HMDA home improvement	626	--	2,831	--
HMDA multifamily	52	--	130,041	--
<b>Total HMDA-related</b>	<b>6,753</b>	<b>68</b>	<b>1,290,515</b>	<b>75</b>
<b>Total small business</b>	<b>3,239</b>	<b>32</b>	<b>424,913</b>	<b>25</b>
<b>TOTAL LOANS</b>	<b>9,992</b>	<b>100</b>	<b>\$1,715,428</b>	<b>100</b>

Note: Affiliate loans include only loans originated or purchased within the bank’s assessment areas.

**Assessment Area Concentration:** Discuss the level of lending activity inside and outside all the bank’s assessment areas, using the Assessment Area Lending Table below. (Adjust the table if small farm, consumer, or other loan types are being evaluated.) It is not necessary to state a conclusion regarding assessment area concentration since this is factored into the overall lending activity conclusion. Provide a discussion if there is a high level of lending outside the assessment area. Refer to Core Table 1: Lending Volume, for additional information about assessment area lending.

EXHIBIT 2  
**Lending Inside and Outside the Assessment Area**

	Inside				Outside			
	#	%	\$ (000s)	%	#	%	\$ (000s)	%
HMDA home improvement	617	99	2,786	98	9	1	45	2
HMDA multifamily	45	87	111,581	86	7	13	18,460	14
<b>Total HMDA-related</b>	<b>662</b>	<b>98</b>	<b>114,367</b>	<b>86</b>	<b>16</b>	<b>2</b>	<b>18,505</b>	<b>14</b>
<b>Total small business</b>	<b>3,180</b>	<b>98</b>	<b>414,159</b>	<b>97</b>	<b>59</b>	<b>2</b>	<b>10,754</b>	<b>3</b>
<b>TOTAL LOANS</b>	<b>3,842</b>	<b>98</b>	<b>\$528,526</b>	<b>98</b>	<b>75</b>	<b>2</b>	<b>\$29,259</b>	<b>5</b>

Note: Affiliate loans not included.

**Geographic and Borrower Distribution:** State a conclusion (for example, “excellent,” “good,” “adequate”) regarding each of these elements of the lending test. Remember that overall conclusions are based on performance in the various assessment areas. It is not necessary to recalculate geographic and borrower distribution data for all the bank’s assessment areas combined. Support your conclusions by specifying the ratings/conclusions in the various assessment areas states or MAs (as applicable) that were factored into the conclusions about the bank’s overall performance. Discuss performance in general. Detailed discussions should be reserved for assessment area write-ups.

With respect to geographic distribution, note whether or not any significant lending gaps in contiguous geographies unexplained by performance context were found. If there were such lending gaps indicate in which assessment area(s) they occurred and include a cross-reference to the appropriate section of the evaluation.

In addition, discuss any significant qualitative aspects that may have augmented the bank’s overall geographic or borrower performance. This can include innovative or flexible lending practices or products that are available in all assessment areas. Describe the product or practice briefly and indicate in what way it assisted low- and moderate-income (LMI) geographies and/or LMI borrowers. State the volume of loans originated through the programs and that they are included in the overall volume of loans evaluated. If the products or practices are unique to specific states or assessment areas, they should be mentioned only briefly, and the reader should be directed to the appropriate section of the evaluation for a more detailed discussion.

**Community Development Lending:** State a conclusion about the level of community development lending (for example, “the bank is a leader,” “its level of . . . is relatively high,” “its level of . . . is adequate”) overall and in states or full-scope MAs, whichever is applicable. Note if any activity was outside the bank’s assessment area and explain why such activity was given consideration. Explain when any areas were given greater weight than others were. Refer as appropriate to issues relating to performance context and availability of opportunities. Provide the total of community development loans (number and dollar amount) in all the bank’s assessment areas combined. Similarly, provide these totals for “other community development lending activity” that was considered, such as letters of credit. Include general comments and specific examples of qualitative aspects of the activity that may have augmented performance, such as responsiveness to need, degree of innovation, or complexity. Other than in the examples, details about the qualitative aspects of the loans should be presented in the discussions of the state or assessment area where the loans are located. Refer to Core Table 1 for information on the level of community development lending in the individual assessment areas.

**INVESTMENT TEST**

State the rating (for example, “outstanding,” “high satisfactory,” “low satisfactory”) with respect to the investment test overall and provide a brief explanation to support this rating. This explanation should include the ratings of the states or conclusions about full-scope MAs, whichever is applicable. Note if any activity was outside the bank’s assessment area and explain why such activity was given consideration. Explain when any areas were given greater weight than others were. Provide the total amount of investments (number and dollar amount) in all the assessment areas combined, and state a conclusion (for example, “excellent,” “significant,” “adequate”) regarding the level of activity. Note if any investments were given greater weight than others were and explain why. Give the details of any investments that assist the overall, regional, or multiple assessment areas. Indicate if the amounts of such investments are in addition to or included in the specific assessment area activity shown in Core Table 14, which should be cross-referenced. Make general comments and provide specific examples of the qualitative aspects that may have augmented performance, such as responsiveness to need, degree of innovation, or complexity. Other than in the examples, details about the qualitative aspects of investments should be presented in the discussions of the state or assessment area to which the investments relate.

**SERVICE TEST**

State the rating (for example, “outstanding,” “high satisfactory,” “low satisfactory”) with respect to the service test. Support your rating by specifying the ratings/conclusions in the various assessment areas (states or MAs as applicable) that were factored into the conclusions about the bank’s overall performance. State general conclusions regarding each element of the retail service portion as well as the community development service portion of the test, using the terminology of Appendix A to Regulation BB, which describes the various performance levels. Detailed discussions should be reserved for assessment area write-ups. However, if there are particular assessment areas in which performance was exceptionally good or bad, you may mention the assessment area(s) and provide a cross-reference to the section of the evaluation in which detailed information is presented. Products should be described generally, and a statement should be made that they are available as described throughout all the assessment areas unless otherwise noted.

**COMPLIANCE WITH ANTIDISCRIMINATION LAWS**

As previously noted, write a paragraph about the institution’s record of complying with the antidiscrimination laws. Use the guidelines on page 3.

## MULTISTATE METROPOLITAN AREA

**CRA RATING FOR** *(Name of Multistate Metropolitan Area, Including State Names):<sup>1</sup>*

*The lending test is rated:*

*The investment test is rated:*

*The service test is rated:*

*[Complete for each multistate metropolitan area where an institution has branches in two or more states within the multistate metropolitan area.]*

Summarize the major factors supporting the institution's multistate metropolitan area rating. When illegal discrimination or discouragement has been identified and has affected the rating, the conclusion should include a statement that the rating was influenced by violations of the substantive provisions of the antidiscrimination laws. The conclusion should not mention any technical violations of the antidiscrimination laws.

### NOTE

Present a bullet point summary supporting the ratings with respect to each test.

## SCOPE OF EXAMINATION

Write a short description of the scope of the examination within the multistate MA. Discuss how CRA activities in the multistate MA were reviewed (using the examination procedures or through an analysis of available facts and data), and the time period covered in the review.

### NOTE

In addition to the above, indicate any variance from the information presented in the scope section of the institution portion of this document and explain the reason(s) for the variance. If there is more than one assessment area in the multistate metropolitan area, refer to the state and metropolitan area portions of this document for guidance.

<sup>1</sup> This rating reflects performance within the multistate metropolitan area. The statewide evaluations are adjusted and do not reflect performance in the parts of those states contained within the multistate metropolitan area.

**DESCRIPTION OF INSTITUTION'S OPERATIONS IN (NAME OF MULTISTATE METROPOLITAN AREA)**

Describe the institution's operations within the multistate metropolitan area, including a description of each of the assessment area(s) that it serves within the multistate metropolitan area. Information that may be important includes: total assets; asset/loan portfolio mix; primary business focus; branching network; and any merger or acquisition activity. For each of the assessment areas served, include key information such as the number of branches within the assessment area and the number of individuals and geographies in each income category. Indicate how many of those assessment areas were reviewed using the examination procedures.

Other information that may be important includes population trends, type and condition of housing stock, available employment, and general business activity. Also include a summary of any credit needs identified and particular lending opportunities which were noted. Discuss, if appropriate, the number and kinds of CRA-related community contacts that were consulted and relevant information obtained and used, if any, in the CRA evaluation. Typically, more detailed information will be presented for assessment areas reviewed using the examination procedures. Charts and tables may be used to effectively present information as appropriate, particularly for assessment areas that are not reviewed using the examination procedures.

**NOTE**

In addition to the above, identify the states, counties and major cities that constitute the MA and provide the following data: total deposits in the MA, MA deposits as a percentage of the state's overall total deposits, and the institution's deposit share in the MA. Discuss qualitative aspects that may have influenced the bank's performance, such as the level of competition and length of time in the market. Insert the demographic information table below, which provides most demographic details. In addition, discuss HUD adjusted-income ranges, unemployment rates and major employers, and provide an overview of the economy together with any other relevant performance context information you used, including information obtained from community contacts.

EXHIBIT 3  
Assessment Area Demographics

Income Categories	Tract Distribution		Families by Tract Income		Families < Poverty Level as % of Families by Tract		Families by Family Income	
	#	%	#	%	#	%	#	%
Low-income	39	14.6	37,694	7.8	15,579	41.3	113,168	23.3
Moderate-income	57	21.3	90,481	18.6	20,899	23.1	79,578	16.4
Middle-income	96	36.0	192,219	39.6	23,846	12.4	93,094	19.2
Upper-income	75	28.1	164,819	34.0	8,355	5.1	199,373	41.1
<b>Total Assessment Area</b>	<b>267</b>	<b>100.0</b>	<b>485,213</b>	<b>100.0</b>	<b>68,679</b>	<b>14.2</b>	<b>485,213</b>	<b>100.0</b>
	<b>Housing Units by Tract</b>	<b>Housing Types by Tract</b>						
		<b>Owner-occupied</b>		<b>Rental</b>		<b>Vacant</b>		
	#	%	#	%	#	%	#	%
Low-income	71,485	12,252	3.3	17.1	50,122	70.1	9,111	12.7
Moderate-income	150,066	48,351	12.9	32.2	87,510	58.3	14,205	9.5
Middle-income	292,074	153,540	40.8	52.6	110,334	37.8	28,200	9.7
Upper-income	257,663	161,863	43.0	62.8	68,383	26.5	27,417	10.6
<b>Total Assessment Area</b>	<b>771,288</b>	<b>375,006</b>	<b>100.0</b>	<b>48.8</b>	<b>316,349</b>	<b>41.0</b>	<b>78,933</b>	<b>10.2</b>
	<b>Total Businesses by Tract</b>	<b>Businesses by Tract &amp; Revenue Size</b>						
		<b>Less Than or = \$1 Million</b>		<b>Over \$1 Million</b>		<b>Revenue Not Reported</b>		
	#	%	#	%	#	%	#	%
Low-income	8,402	10.1	7,096	9.9	1,306	10.9	0	--
Moderate-income	15,865	19.0	13,177	18.4	2,688	22.5	0	--
Middle-income	25,892	31.0	23,028	32.2	2,864	23.9	0	--
Upper-income	33,388	40.0	28,274	39.5	5,114	42.7	0	--
Tract not reported	0	0.0	0	0.0	0	0	0	--
<b>Total Assessment Area</b>	<b>83,547</b>	<b>100.0</b>	<b>71,575</b>	<b>100.0</b>	<b>11,972</b>	<b>100.0</b>	<b>0</b>	<b>--</b>
	<b>Percentage of Total Business:</b>		<b>85.7</b>		<b>14.3</b>			

**CONCLUSIONS WITH RESPECT TO PERFORMANCE TESTS IN  
(NAME OF MULTISTATE METROPOLITAN AREA)**

Discuss the institution's CRA performance within the multistate metropolitan area, including institution strengths and areas for improvement. The narrative should clearly demonstrate how the results of each of the performance test analyses factored into the rating. Support your conclusions with an analysis of facts and data, such as the number and volume of loans and investments, by type, across geographies and borrower categories in the assessment areas reviewed using the examination procedures. In addition, support your conclusions with a discussion of facts and data for assessment areas reviewed using the limited examination procedures when appropriate. Indicate whether the institution's performance in the assessment areas reviewed without using the examination procedures is consistent with the institution's record in assessment areas reviewed using the examination procedures in the multistate metropolitan area. Charts and tables should be used whenever possible to summarize and effectively present the most critical or informative data used by the examiner in analyzing the institution's performance and reaching conclusions.



**NOTE**

The discussion of conclusions should reflect the following format:

**LENDING TEST**

State a rating with respect to the lending test (for example, “outstanding,” “high satisfactory,” “low satisfactory”) and briefly explain the basis for the rating.

**Lending Activity:** State a conclusion (for example, “excellent,” “good,” “adequate”) regarding lending activity and refer to Core Table 1: Lending Volume for details. Explain the basis of your conclusion, and, as applicable, include performance context information.

**Geographic Distribution:** State a conclusion (for example, “excellent,” “good,” “adequate”) regarding the overall geographic distribution of loans and refer to Core Tables 2 through 7 and Table 13, as applicable, for details. Explain the basis of your conclusion, with reference to applicable performance context and community contact information. Discuss performance with respect to each of the following loan products, as applicable: HMDA-related (for example, home purchase loans, refinancings) small business, small farm, and consumer. For each product category:

1. State a conclusion (for example, “excellent,” “good,” “adequate”) concerning the evaluation of performance in relation to the appropriate demographic and aggregate data contained in the core tables, and insert key numbers as necessary.
2. Discuss separately performance in LMI geographies.
3. Discuss any significant lending gaps in contiguous geographies.
4. Discuss any qualitative aspects of lending performance that may have augmented performance, such as innovative or flexible lending practices or products. Products or practices already discussed in detail at the institution level should be mentioned only briefly. However, for those products or practices unique to the multistate metropolitan area, provide a more detailed description of the product(s) or practice(s) and indicate in what way LMI geographies were assisted. Include information on the volume of loans originated through the programs and indicate that the loans are included in the overall volume of loans evaluated.

**Distribution by Borrower Income and Revenue Size of the Business:** State a conclusion (for example, “excellent,” “good,” “adequate”) regarding the overall distribution of loans by borrower income and revenue size of the business. Refer to Core Tables 8 through 13, as applicable, for details. Explain the basis of your conclusion, and include applicable performance context and community contact information. Discuss separately performance with respect to HMDA-related, small business loans, consumer and small farm loans, as applicable. For each product category:

1. State a conclusion (for example, “excellent,” “good,” “adequate”) regarding the evaluation of performance in relation to the appropriate demographic and aggregate information provided in the tables, using key numbers as necessary.
2. For HMDA-related and consumer loans, discuss performance separately in relation to LMI borrowers.
3. Discuss any qualitative aspects of lending performance that may have augmented performance levels, such as innovative or flexible lending practices or products. Products or practices already discussed in detail at the institution level should be mentioned only briefly. However, for those products or practices unique to the multistate metropolitan area, provide general descriptions of the product(s) or practice(s) and indicate in what way LMI borrowers were assisted. Include information about the volume of loans originated through the programs and indicate that the loans are included in the overall volume of loans evaluated.

**Community Development Loans:** State a conclusion about the level of community development lending (for example, “the bank is a leader,” “makes a relatively high level of” or, “makes an adequate level of . . .”) and refer as appropriate to issues relating to performance context and availability of opportunities. State the total of community development loans (number and dollar amount) in the multistate area, and reference Core Table 1 for loan volume in the individual assessment areas. In addition, state the total in the multistate area of “other community development activity” considered, such as letters of credit. Provide details on and specific examples of the qualitative aspects that may have augmented performance, such as responsiveness to need, degree of innovation, or complexity.

#### **INVESTMENT TEST**

State a rating (for example, “outstanding,” “high satisfactory,” “low satisfactory”) with respect to the investment test. Note the combined total, in number and dollar amount, of all investments in the MA assessment area, and direct the reader to Core Table 14 for MA details. Note if any investments were given greater weight than others were and explain why. Comment on the qualitative aspects that may have augmented performance, such as responsiveness to need, degree of innovation, or complexity. Provide significant examples of qualified investments to substantiate your conclusions.

### **SERVICE TEST**

State a rating (for example, “outstanding,” “high satisfactory,” “low satisfactory”) with respect to the overall service test and briefly explain the basis for the rating.

#### **Retail Services**

For retail services, state a conclusion regarding each of the following items. Use the terminology of Appendix A of Regulation BB for describing the various performance levels:

1. Accessibility of branches, with a reference to Core Table 15 for details and a comparison of branch locations with the population information provided in the table.
2. Availability of alternative delivery systems that may effectively enhance service to LMI geographies or persons.
3. Changes in branch locations (as shown in Table 15) and the impact on LMI geographies or persons.
4. Reasonableness of services if it differs from the overall.

#### **Community Development Services**

State a conclusion (for example, “leader in providing,” “provides a relatively high level”) regarding community development services and provide details and specific examples representative of the institution’s activity.

## STATE

**CRA RATING FOR (Name of State):<sup>2</sup>****The lending test is rated:****The investment test is rated:****The service test is rated:**

*[Complete for each state in which an institution has branches if the institution has branches in two or more states. For an institution that has branches in only one state, complete the Metropolitan Area and Non-Metropolitan Statewide Area presentations only for that state, as applicable in light of the location of the branches.]*

Summarize the major factors supporting the institution's state rating. When illegal discrimination or discouragement has been identified and has affected the rating, the conclusion should include a statement that the rating was influenced by violations of the substantive provisions of the antidiscrimination laws. The conclusion should not mention any technical violations of the antidiscrimination laws.

**NOTE**

Present a bullet point summary to support the ratings with respect to each test.

## SCOPE OF EXAMINATION

Write a short description of the scope of the examination within the state. Discuss how CRA activities in the state were reviewed (which metropolitan areas or non-metropolitan statewide areas included assessment areas that were reviewed using the full examination procedures and which metropolitan areas were reviewed through an analysis of available facts and data), and the time period covered in the review.

**NOTE**

In addition to the above, indicate any variance from the information presented in the scope section of the institution portion of the document and explain the reason(s) for the variance. Specify which assessment areas had full reviews and which had limited ones and note if any areas fully reviewed were given greater weight in reaching conclusions.

<sup>2</sup> For institutions with branches in two or more states in a multistate metropolitan area, this statewide evaluation is adjusted and does not reflect performance in the parts of those states contained within the multistate metropolitan area. Refer to the multistate metropolitan area rating and discussion for the rating and evaluation of the institution's performance in that area.

## DESCRIPTION OF INSTITUTION'S OPERATIONS IN (NAME OF STATE)

Describe the institution's operations within the state, including a description of the assessment area(s) served. Information that may be important includes: total statewide assets; asset/loan portfolio mix; primary business focus; branching network; any merger or acquisition activity; and a brief description of the metropolitan areas, non-metropolitan areas, and assessment areas served within the state.

### NOTE

In addition to the above, specify the MAs that are included in the state's assessment areas and their general location in the state, and provide data on the following: total deposits in the state, state deposits as a percentage of the bank's overall total deposits, and the bank's deposit share in the state. In addition, discuss qualitative aspects that may have influenced the bank's performance, such as the level of competition and length of time in the market. General information concerning the total population of the combined assessment areas, income ranges and unemployment levels, and a broad economic overview should also be presented. Include a general discussion of credit needs in the assessment area(s) and any information from community contacts that is applicable to the entire state. Specific demographic information is to be presented in the discussions relating to the individual assessment areas.

## CONCLUSIONS WITH RESPECT TO PERFORMANCE TESTS IN (NAME OF STATE)

Discuss the institution's CRA performance within the state. The facts, data and analyses that were used to form a conclusion about the rating should be reflected in the narrative, including institution strengths and areas for improvement. The narrative should clearly demonstrate how the results of each of the performance test analyses factored into the rating. Charts and tables should be used whenever possible to summarize and effectively present the most critical or informative data used by the examiner in analyzing the institution's performance and reaching conclusions.

### NOTE

Use the following format for the discussion of conclusions:

#### LENDING TEST

State the rating (for example, "outstanding," "high satisfactory," "low satisfactory") with respect to the lending test and provide a brief explanation to support the rating. The explanation should include the conclusions for the full-scope MAs evaluated at the examination. Explain when any areas were given greater weight than others were.

**Lending Activity:** State a conclusion (for example, "excellent," "good," "adequate") regarding

lending activity. Insert the Total Lending Activity Table into the text (see example in institution section) showing the number and dollar value of all applicable loans originated or purchased by the bank and its affiliates, if applicable, in all assessment areas in the state. Make reference to Core Table 1: Lending Volume for further information about lending in specific assessment areas. You may note strengths or weaknesses in lending activity in specific assessment areas if necessary; however, details should usually be given only in the discussions of the specific assessment areas.

**Geographic and Borrower Distribution:** State a conclusion (for example, “excellent,” “good,” “adequate”) regarding each of these elements of the lending test. Remember that overall conclusions are based on performance in the various assessment areas, and it is not necessary to calculate performance data for all the assessment areas in the state. Provide support by specifying the conclusions in the various assessment areas that were factored into the bank’s overall performance. Discuss performance in general. Detailed discussions should be reserved for assessment area write-ups.

With respect to geographic distribution, provide a general discussion of any significant lending gaps in contiguous geographies that were found. Details should be provided in the discussion of the assessment area concerned.

In addition, discuss any significant qualitative aspects that may have augmented the bank’s performance levels in the state, for example, innovative or flexible lending practices or products that are available throughout the assessment areas in the state. Provide a general description of the product(s) or practice(s) and indicate in what way LMI geographies and/or LMI borrowers were assisted. Include information on the volume of loans originated under the programs and indicate that the loans are included in the overall volume of loans evaluated. If such products or practices are unique to specific assessment areas, they should be mentioned only briefly and the reader should be directed to the appropriate section(s) of the evaluation for details.

**Community Development Loans:** State a conclusion about the level of community development lending (for example, “the bank is a leader,” “makes a relatively high level,” “makes an adequate level”) overall and in full-scope MAs. Explain when any areas were given greater weight than others were. Refer as appropriate to issues pertaining to performance context and availability of opportunities. State the total of community development loans (number and dollar amount) in all the assessment areas in the state combined, and direct the reader to Core Table 1 for data on the volume of loans in each assessment area. In addition, state the total of “other community development activity” considered, such as letters of credit. Provide general comments and specific examples of qualitative aspects that may have augmented performance, such as responsiveness to need, degree of innovation, or complexity. Other than in the examples, details about the qualitative aspects of loans should be presented in the discussions of the assessment areas in which the loans are located.

**INVESTMENT TEST**

State the rating (for example, “outstanding,” “high satisfactory,” “low satisfactory”) with respect to the investment test in the state and in the full-scope MAs. Explain when any areas were given greater weight than others were. Provide the total amount of investments (number and dollar) for all the assessment areas in the state combined and state a conclusion regarding evaluation of the level of activity (for example, “excellent,” “significant,” “adequate”). Note if any investments were given greater weight than others were and explain why. Describe the details of any investments that assist the state’s overall assessment areas. Indicate if such amounts are in addition to or included in the specific assessment area activity shown in Core Table 14: Qualified Investments, and direct the reader to that table. Comment generally on the qualitative aspects that may have augmented performance, such as responsiveness to need, degree of innovation, or complexity. Details of qualitative aspects of investments should be presented in the discussions of the assessment areas to which the investments relate.

**SERVICE TEST**

State the rating (for example, “outstanding,” “high satisfactory,” “low satisfactory”) with respect to the service test and support your rating by specifying the conclusions in the various assessment areas that were factored into the rating of the bank’s performance. State conclusions about performance regarding each element of the retail service portion of the test as well as to the community development service portion. Use the terminology of Regulation BB Appendix A, which describes the various performance levels. Detailed discussions should be reserved for assessment area write-ups. However, if there are particular assessment areas in which performance was exceptionally good or bad, you may mention the assessment area(s) and refer to the section(s) of the document in which detailed information is presented. Discuss any differences in products offered that are unique to the state.

## **METROPOLITAN AREAS**

*(For metropolitan areas with some or all assessment areas reviewed using the examination procedures.)*

### **DESCRIPTION OF INSTITUTION'S OPERATIONS IN (Name of Metropolitan Area & State)**

Describe the institution's operations within the metropolitan area, including a description of each of the assessment area(s) that it serves within the metropolitan area. Information that may be important includes: the number of branches within the assessment areas and the number of individuals and geographies in each income category. Indicate how many of those assessment areas were reviewed using the full examination procedures. Other information that may be important includes population trends, income levels, type and condition of housing stock, available employment, and general business activity. Also include a summary of any credit needs identified and particular lending opportunities which were noted.

Discuss, if appropriate, the number and kinds of CRA-related community contacts that were consulted and relevant information obtained and used, if any, in the CRA evaluation. Typically, more detailed information will be presented for assessment areas reviewed using the full examination procedures. Charts and tables may be used to effectively present information as appropriate, particularly for assessment areas that are reviewed using the limited examination procedures.

#### **NOTE**

In addition to the above, specify the counties and major cities that make up the MA and include data on the following: total deposits in the MA, MA deposits as a percentage of the state's overall total deposits, and the bank's deposit share in the MA. Discuss qualitative aspects that may have influenced the bank's performance, such as the level of competition and length of time in the market. Insert the demographic information table below, which provides primary demographic details. Finally, discuss HUD adjusted-income levels, unemployment rates and major employers, and provide an overview of the economy and any other relevant performance context information you used, including information obtained from community contacts.



EXHIBIT 3  
Assessment Area Demographics  
(Insert name of assessment area)

Income Categories	Tract Distribution		Families by Tract Income		Families < Poverty Level as % of Families by Tract		Families by Family Income		
	#	%	#	%	#	%	#	%	
Low-income	39	14.6	37,694	7.8	15,579	41.3	113,168	23.3	
Moderate-income	57	21.3	90,481	18.6	20,899	23.1	79,578	16.4	
Middle-income	96	36.0	192,219	39.6	23,846	12.4	93,094	19.2	
Upper-income	75	28.1	164,819	34.0	8,355	5.1	199,373	41.1	
<b>Total Assessment Area</b>	<b>267</b>	<b>100.0</b>	<b>485,213</b>	<b>100.0</b>	<b>68,679</b>	<b>14.2</b>	<b>485,213</b>	<b>100.0</b>	
	<b>Housing Units by Tract</b>	<b>Housing Types by Tract</b>							
		<b>Owner-occupied</b>			<b>Rental</b>		<b>Vacant</b>		
		#	%	%	#	%	#	%	
Low-income	71,485	12,252	3.3	17.1	50,122	70.1	9,111	12.7	
Moderate-income	150,066	48,351	12.9	32.2	87,510	58.3	14,205	9.5	
Middle-income	292,074	153,540	40.8	52.6	110,334	37.8	28,200	9.7	
Upper-income	257,663	161,863	43.0	62.8	68,383	26.5	27,417	10.6	
<b>Total Assessment Area</b>	<b>771,288</b>	<b>375,006</b>	<b>100.0</b>	<b>48.8</b>	<b>316,349</b>	<b>41.0</b>	<b>78,933</b>	<b>10.2</b>	
	<b>Total Businesses by Tract</b>	<b>Businesses by Tract &amp; Revenue Size</b>							
				<b>Less Than or = \$1 Million</b>		<b>Over \$1 Million</b>		<b>Revenue Not Reported</b>	
		#	%	#	%	#	%	#	%
Low-income	8,402	10.1	7,096	9.9	1,306	10.9	0	--	
Moderate-income	15,865	19.0	13,177	18.4	2,688	22.5	0	--	
Middle-income	25,892	31.0	23,028	32.2	2,864	23.9	0	--	
Upper-income	33,388	40.0	28,274	39.5	5,114	42.7	0	--	
Tract not reported	0	0.0	0	0.0	0	0	0	--	
<b>Total Assessment Area</b>	<b>83,547</b>	<b>100.0</b>	<b>71,575</b>	<b>100.0</b>	<b>11,972</b>	<b>100.0</b>	<b>0</b>	<b>--</b>	
	<b>Percentage of Total Business:</b>		<b>85.7</b>		<b>14.3</b>				

**CONCLUSIONS WITH RESPECT TO PERFORMANCE TESTS IN  
(NAME OF METROPOLITAN AREA AND STATE)**

Discuss the institution's CRA performance within the metropolitan area, including institution strengths and areas for improvement. The narrative should clearly demonstrate how the results of each of the performance test analyses factored into the conclusions. Support your conclusions with an analysis of facts and data, such as the number and volume of loans and investments, by type, across geographies and borrower categories in the assessment areas reviewed using the full examination procedures. In addition, support your conclusions with a discussion of facts and data for assessment areas reviewed using the limited examination procedures when appropriate. Indicate whether the institution's performance in the assessment areas reviewed using the limited examination procedures is consistent with the institution's record in assessment areas reviewed using the full examination procedures in the metropolitan area. Charts

and tables should be used whenever possible to summarize and effectively present the most critical or informative data used by the examiner in analyzing the institution's performance and reaching conclusions.

#### NOTE

Use the following format for the discussion:

#### LENDING TEST

State a conclusion with respect to the lending test (for example, "excellent," "good," "adequate") and provide a brief explanation, including performance context information, as applicable, to support the conclusion.

**Lending Activity:** State a conclusion (for example, "excellent," "good," "adequate,") regarding lending activity and direct the reader to Core Table 1: Lending Volume for details. Explain the basis of your conclusion, with reference to any applicable performance context information.

**Geographic Distribution:** State a conclusion (for example, "excellent," "good," "adequate") regarding the overall geographic distribution of loans and direct the reader to Core Tables 2 through 7 and Table 13, as applicable, for details. Explain the basis of your conclusion, with reference to any applicable performance context and community contact information. Discuss separately performance with respect to HMDA-related products, such as home purchase loans and refinancings, as well as with respect to small business and small farm loans and consumer loans, as applicable. For each product category:

1. State a conclusion (for example, "excellent," "good," "adequate") regarding performance, with reference to the appropriate demographic and aggregate information contained in the core tables, and insert key numbers as necessary.
2. Discuss separately performance in LMI geographies.
3. Discuss any significant lending gaps in contiguous geographies.
4. Discuss any qualitative aspects of lending performance that may have augmented performance. These may include innovative or flexible lending practices or products that are available throughout the bank's assessment areas or that are unique to the particular assessment area. Products or practices already discussed in detail at the institution or state level should be mentioned only briefly. However, for those products or practices unique to the assessment area, provide details about the product(s) or practice(s) and indicate in what way LMI geographies were assisted. Include information concerning the volume of loans originated under the programs and indicate that the loans are included in the overall volume of loans evaluated.

**Distribution by Borrower Income and Revenue Size of the Business:** State a conclusion (for example, “excellent,” “good,” “adequate”) regarding the overall distribution of loans by borrower income and revenue size of the business. Refer to Core Tables 8 through 13, as applicable, for details. Explain the basis of your conclusion, with reference to any applicable performance context and community contact information. Discuss separately performance with respect to HMDA-related loans, small business loans, small farm loans, and consumer loans, as applicable. For each product category:

1. State a conclusion (for example, “excellent,” “good,” “adequate”) regarding performance in relation to the appropriate demographic and aggregate information provided in the tables, using key numbers as necessary.
2. For HMDA-related and consumer loans, discuss separately performance with respect to LMI borrowers.
3. Discuss any qualitative aspects of lending performance that may have augmented performance levels. These may include innovative or flexible lending practices or products that are available throughout the bank’s assessment areas or that are unique to the particular assessment area. Products or practices already discussed in detail at the institution or state level should be mentioned only briefly. However, for those products or practices unique to the assessment area, provide a more detailed description of the product(s) or practice(s) and indicate in what way LMI borrowers were assisted. Include information on the volume of loans originated under the programs and indicate that they are included in the overall volume of loans evaluated.

**Community Development Lending:** State a conclusion (for example, “the bank is a leader,” “makes a relatively high level of . . .,” “makes an adequate level of . . .”) for community development lending, and refer to performance context and availability of opportunities issues, as appropriate. State the volume of loans originated and purchased, and note any “other community development activity” that was considered, such as letters of credit. Indicate the level (number and dollar amount) of community development lending directed toward each of the four community development categories (for example, affordable housing) and include significant examples as warranted.

#### **INVESTMENT TEST**

State a conclusion (for example, “excellent,” “good,” “adequate”) regarding the level of investments. Note the number and dollar amount of investments in the assessment area, and direct the reader to Core Table 14 for details. Note if any investments were given greater weight than others were and explain why. Comment on the qualitative aspects that may have augmented performance levels, such as responsiveness to need, degree of innovation, or complexity. Provide significant examples of qualified investments to substantiate your conclusions.

#### **SERVICE TEST**

State a conclusion (for example, “excellent,” “good,” “adequate”) for the overall service test and the basis for the conclusion.

**Retail Services**

For retail services, using the terminology in Appendix A to Regulation BB, state a conclusion based on the following:

1. Accessibility of branches, with a reference to Core Table 15 for details and a comparison of branch locations with the population information provided in the table.
2. Availability of alternative delivery systems that may effectively enhance service to LMI geographies or persons.
3. Changes in branch locations (as shown in Table 15) and the impact on LMI geographies or persons.
4. Reasonableness of services if conclusion differs from that for the services overall.

**Community Development Services:**

State a conclusion (for example, “leader in providing,” “provides a relatively high level”) regarding community development services and provide details concerning and examples of the bank’s activity.

## **METROPOLITAN AREAS**

*(For each metropolitan area where no assessment areas were reviewed using the examination procedures.)*

### **DESCRIPTION OF INSTITUTION'S OPERATIONS IN (NAME OF METROPOLITAN AREA AND STATE)**

Describe the institution's operations within the metropolitan area, including a description of each of the assessment area(s) that it serves within the metropolitan area. Include key information such as the number of branches within the assessment areas and the number of individuals and geographies in each income category.

### **CONCLUSIONS WITH RESPECT TO PERFORMANCE TESTS IN (NAME OF METROPOLITAN AREA AND STATE)**

Summarize the facts and data that were reviewed, including demographic information on the assessment areas and information on the institution's performance. Indicate whether the institution's performance in the assessment areas reviewed using the limited examination procedures is consistent with the institution's record [overall/in the state], using one of the two following statements:

- a. The institution's [lending, investment, service] performance in the area is consistent with the institution's [lending, investment, service] performance overall [or in the state].
- b. The institution's [lending, investment, service] performance in the area [exceeds/is below], the institution's [lending, investment, service] performance for the [institution/state]; however, it does not change the rating for the [institution/state]

#### **NOTE**

Activity and performance context information for assessment areas having limited reviews is presented in the core tables and should not be repeated here. Conclusions (consistent, exceeds, or below) regarding performance should be entered into a table that includes all limited review assessment areas in a particular state. If there is only one such area, conclusions can be presented in text and no table is necessary.

Please use the following text in your public evaluation:

"Facts and data reviewed, including performance and demographic information, can be found in the tables accompanying this report. Conclusions regarding performance, which did not impact the overall (insert either "institution" or "state") rating, are as follows:"

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<b>Assessment Area</b>	<b>Lending Test</b>	<b>Investment Test</b>	<b>Service Test</b>

## **NON-METROPOLITAN STATEWIDE AREA<sup>3</sup>**

*(If some or all of the assessment areas within the non-metropolitan statewide area were reviewed using the examination procedures.)*

### **NOTE**

For guidance in preparing this portion of the public evaluation, see **METROPOLITAN AREAS** beginning on page 19.

### **DESCRIPTION OF INSTITUTION'S OPERATIONS IN (NAME OF NON-METROPOLITAN AREA AND STATE)**

Describe the institution's operations within the non-metropolitan statewide area, including a description of each of the assessment area(s) that it serves within the non-metropolitan statewide area. Information that may be important includes the number of branches within the assessment areas and the number of individuals and geographies in each income category. Indicate how many of those assessment areas were reviewed using the full examination procedures. Other information that may be important includes population trends, income levels, type and condition of housing stock, available employment, and general business activity. Also include a summary of any credit needs identified and particular lending opportunities which were noted.

Discuss, if appropriate, the number and kinds of CRA-related community contacts that were consulted and relevant information obtained and used, if any, in the CRA evaluation. Typically, more detailed information will be presented for assessment areas reviewed using the full examination procedures. Charts and tables may be used to effectively present information as appropriate, particularly for assessment areas that are reviewed using the limited examination procedures.

<sup>3</sup> The discussion of an institution's CRA performance within a non-metropolitan statewide area is only required for institutions with branches in two or more states. A separate discussion of CRA performance within a non-metropolitan statewide area for intrastate banks that have branches in metropolitan and non-metropolitan areas is optional because the performance in the non-metropolitan areas have been reviewed and discussed in the overall evaluation of the institution. Examiners may wish to discuss in greater detail, however, the assessment areas within non-metropolitan areas that were reviewed using the examination procedures for intrastate banks with branches in metropolitan and non-metropolitan areas, or for intrastate banks with branches only in non-metropolitan areas.

**CONCLUSIONS WITH RESPECT TO PERFORMANCE TESTS IN  
(NAME OF NON-METROPOLITAN AREA AND STATE)**

Discuss the institution's CRA performance within the non-metropolitan statewide area. The facts, data and analyses that were used to form a conclusion should be reflected in the narrative, including institution strengths and areas for improvement. The narrative should clearly demonstrate how the results of each of the performance test analyses factored into the conclusions for the non-metropolitan statewide area. Support your conclusions with an analysis of facts and data, such as the number and volume of loans and investments, by type, across geographies and borrower categories in the assessment areas reviewed using the full examination procedures. In addition, support your conclusions with a discussion of facts and data for assessment areas reviewed using the limited examination procedures when appropriate. Indicate whether the institution's performance in the assessment areas reviewed using the limited examination procedures is consistent with the institution's record in assessment areas reviewed using the full examination procedures in the non-metropolitan statewide area.

Charts and tables should be used whenever possible to summarize and effectively present the most critical or informative data used by the examiner in analyzing the institution's performance and reaching conclusions.



## **NON-METROPOLITAN STATEWIDE AREA<sup>4</sup>**

*(If none of the assessment areas within the non-metropolitan statewide area were reviewed using the examination procedures.)*

### **DESCRIPTION OF INSTITUTION'S OPERATIONS IN (NAME OF NON-METROPOLITAN AREA AND STATE)**

Describe the institution's operations within the non-metropolitan statewide area, including a description of each of the assessment area(s) that it serves. Include key information such as the number of branches within each assessment area and the number of individuals and geographies in each income category.

### **CONCLUSIONS WITH RESPECT TO PERFORMANCE TESTS IN (NAME OF NON-METROPOLITAN STATEWIDE AREA)**

Summarize the facts and data that were reviewed, including demographic information on the assessment areas and information on the institution's performance. Indicate whether the institution's performance in the assessment areas reviewed using the limited examination procedures is consistent with the institution's record [overall/in the state], using one of the two following statements:

- a. The institution's [lending, investment, service] performance in the area is consistent with the institution's [lending, investment, service] performance overall [or in the state].
- b. The institution's [lending, investment, service] performance in the area [exceeds/is below], the institution's [lending, investment, service] performance for the [institution/state]; however, it does not change the rating for the [institution/state].

#### **NOTE**

For guidance in preparing this portion of the public evaluation, see **METROPOLITAN AREAS** beginning on page 24.

4. The discussion of an institution's CRA performance within a non-metropolitan statewide area is only required for institutions with branches in two or more states. A separate discussion of CRA performance within a non-metropolitan statewide area for intrastate banks that have branches in metropolitan and non-metropolitan areas is optional. Examiners may wish to discuss in greater detail, however, the assessment areas within the non-metropolitan areas that were reviewed using the examination procedures for intrastate banks with branches in metropolitan and non-metropolitan areas, or for intrastate banks with branches only in non-metropolitan areas.

## **CRA APPENDIX A**

### **SCOPE OF EXAMINATION**

#### **NOTE**

The Scope of Examination discussion has been moved to the front of the public disclosure. On this page, refer the reader to that discussion, which is on page 3 in this document. There is a statutory requirement that the written evaluation of a multistate institution's performance must list the individual branches examined in each state. Therefore, this appendix must be used for multistate institutions. In addition, large institutions with multiple assessment areas or affiliates subject to examination may warrant the use of charts that convey information regarding the scope of the examination. The following chart may be used as a supplement to the discussion of the scope. If it is used, please refer to Appendix A in your discussion.

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**SCOPE OF EXAMINATION** [SAMPLE]

TIME PERIOD REVIEWED	1/1/95 TO 6/30/96		
FINANCIAL INSTITUTION XYZ State Bank Grand Rapids, MI			PRODUCTS REVIEWED <ul style="list-style-type: none"> <li>• Small Business</li> <li>• Small Farm</li> <li>• Consumer</li>   <li>• Unsecured</li> </ul>
AFFILIATE(S)	AFFILIATE RELATIONSHIP		PRODUCTS REVIEWED
XYZ Mortgage Company	Bank subsidiary		Mortgage loans
XYZ Community Investment Corporation	Holding company subsidiary		Investments
XYZ Credit Card Corporation	Holding company subsidiary		Credit Cards

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LIST OF ASSESSMENT AREAS AND TYPE OF EXAMINATION

ASSESSMENT AREA	TYPE OF EXAMINATION	BRANCHES VISITED <sup>5</sup>	OTHER INFORMATION
ILLINOIS MSA 0008 Decatur Adams County Non-MSA rural Illinois	Full procedures Ltd. procedures Full procedures		Mortgage loans not offered in non-MSA rural areas.
MICHIGAN MSA 0001 Grand Rapids City of Marcellus Non-MSA rural Michigan	Full procedures Full procedures Ltd. procedures		The scope of examination for non-MSA rural Michigan branches encompasses activities for the past six months, coinciding with their acquisition date.

**NOTE**

In the “branches visited” column, insert the names and addresses of the branches where examiners checked for technical compliance (sign and public file, if applicable). Under the table insert the following text:

“Note: “Branches visited” indicates where technical compliance with the CRA (signs, public file, etc.) was confirmed. The evaluation of the institution’s CRA performance takes into consideration activity from all branch locations, as described in the “Scope of Examination.”

5. There is a statutory requirement that the written evaluation of a multistate institution’s performance must list the individual branches examined in each state.

**CRA APPENDIX B**

**SUMMARY OF STATE AND MULTISTATE MSA RATINGS**

State or Multistate Metropolitan Area Name	Lending Test Rating	Investment Test Rating	Service Test Rating	Overall State Rating

**NOTE**

The following appendix has been added to the public disclosure. It is based on the definitions used in relation to the FFIEC core tables. Please do not delete or change any items listed here. You may add items that are appropriate for a particular examination.

**CRA APPENDIX C****GLOSSARY**

**Aggregate lending:** The number of loans originated and purchased by all reporting lenders in specified income categories as a percentage of the aggregate number of loans originated and purchased by all reporting lenders in the metropolitan area/assessment area.

**Block numbering area (“BNA”):** A statistical subdivision of a county for grouping and numbering blocks in non-metropolitan counties where local census statistical area committees have not established census tracts. A BNA does not cross county lines.

**Census tract:** A small subdivision of metropolitan and other densely populated counties. Census tract boundaries do not cross county lines; however, they may cross the boundaries of metropolitan statistical areas. Census tracts usually have between 2,500 and 8,000 persons, and their physical size varies widely depending upon population density. Census tracts are designed to be homogeneous with respect to population characteristics, economic status, and living conditions to allow for statistical comparisons.

**Community development:** Affordable housing (including multifamily rental housing) for low- or moderate-income individuals; community services targeted to low- or moderate-income individuals; activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration’s Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of \$1 million or less; or, activities that revitalize or stabilize low- or moderate-income geographies.

**Consumer loan(s):** A loan(s) to one or more individuals for household, family, or other personal expenditures. A consumer loan does not include a home mortgage, small business, or small farm loan. This definition includes the following categories: motor vehicle loans, credit card loans, home equity loans, other secured consumer loans, and other unsecured consumer loans.

**Family:** Includes a householder and one or more other persons living in the same household who are related to the householder by birth, marriage, or adoption. The number of family households always equals the number of families; however, a family household may also include non-relatives living with the family. Families are classified by type as either a married-couple family or other family, which is further classified into ‘male householder’ (a family with a male householder and no wife present) or ‘female householder’ (a family with a female householder and no husband present).

**Full review:** Performance under the Lending, Investment, and Service Tests is analyzed considering performance context, quantitative factors (for example, geographic distribution, borrower distribution, and total number and dollar amount of investments), and qualitative factors (for example, innovativeness, complexity, and responsiveness).

**Geography:** A census tract or a block numbering area delineated by the United States Bureau of the Census in the most recent decennial census.

**Home Mortgage Disclosure Act (HMDA):** The statute that requires certain mortgage lenders that do business or have banking offices in a metropolitan statistical area to file annual summary reports of their mortgage lending activity. The reports include such data as the race, gender, and the income of applications, the amount of loan requested, and the disposition of the application (for example, approved, denied, and withdrawn).

**Home mortgage loans:** Includes home purchase and home improvement loans as defined in the HMDA regulation. This definition also includes multifamily (five or more families) dwelling loans, loans for the purchase of manufactured homes and refinancings of home improvement and home purchase loans.

**Household:** Includes all persons occupying a housing unit. Persons not living in households are classified as living in group quarters. In 100 percent tabulations, the count of households always equals the count of occupied housing units.

**Limited review:** Performance under the Lending, Investment, and Service Tests is analyzed using only quantitative factors (for example, geographic distribution, borrower distribution, total number and dollar amount of investments, and branch distribution).

**Low-income:** Individual income that is less than 50 percent of the area median income, or a median family income that is less than 50 percent, in the case of a geography.

**Market share:** The number of loans originated and purchased by the institution as a percentage of the aggregate number of loans originated and purchased by all reporting lenders in the MA/assessment area.

**Metropolitan area (MA):** Any primary metropolitan statistical area (“PMSA”), metropolitan statistical area (“MSA”), or consolidated metropolitan area (“CMSA”), as defined by the Office of Management and Budget, with a population of 250,000 or more, and any other area designated as such by the appropriate federal financial supervisory agency.

**Middle-income:** Individual income that is at least 80 percent and less than 120 percent of the area median income, or a median family income that is at least 80 percent and less than 120 percent, in the case of a geography.

**Moderate-income:** Individual income that is at least 50 percent and less than 80 percent of the area median income, or a median family income that is at least 50 percent and less than 80 percent, in the case of a geography.

**Multifamily:** Refers to a residential structure that contains five or more units.

**Other products:** Includes any unreported optional category of loans for which the institution collects and maintains data for consideration during a CRA examination. Examples of such activity include consumer loans and other loan data an institution may provide concerning its lending performance.

**Owner-occupied units:** Includes units occupied by the owner or co-owner, even if the unit has not been fully paid for or is mortgaged.

**Qualified investment:** A qualified investment is defined as any lawful investment, deposit, membership share, or grant that has as its primary purpose community development.

**Rated area:** A rated area is a state or multi-state metropolitan area. For an institution with domestic branches in only one state, the institution's CRA rating would be the state rating. If an institution maintains domestic branches in more than one state, the institution will receive a rating for each state in which those branches are located. If an institution maintains domestic branches in two or more states within a multi-state metropolitan area, the institution will receive a rating for the multi-state metropolitan area.

**Small loan(s) to business(es):** A loan included in 'loans to small businesses' as defined in the Consolidated Report of Condition and Income (Call Report) and the Thrift Financial Reporting (TFR) instructions. These loans have original amounts of \$1 million or less and typically are either secured by nonfarm or nonresidential real estate or are classified as commercial and industrial loans. However, thrift institutions may also exercise the option to report loans secured by nonfarm residential real estate as "small business loans" if the loans are reported on the TFR as nonmortgage, commercial loans.

**Small loan(s) to farm(s):** A loan included in 'loans to small farms' as defined in the instructions for preparation of the Consolidated Report of Condition and Income (Call Report). These loans have original amounts of \$500,000 or less and are either secured by farmland, or are classified as loans to finance agricultural production and other loans to farmers.

**Upper-income:** Individual income that is more than 120 percent of the area median income, or a median family income that is more than 120 percent, in the case of a geography.



**CRA APPENDIX D**

**CORE CRA TABLES**

**NOTE**

Insert all applicable CRA core tables here.

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**CRA APPENDIX E**

**ASSESSMENT AREA MAPS**

**NOTE**

You may include a map of the bank's assessment areas in this optional appendix.



# Wholesale or Limited-Purpose Institutions Examination Procedures and Sample Format for Public Disclosure of Examination Results

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The Examination Procedures for Wholesale or Limited-Purpose Institutions and the Sample Format for Public Disclosure of Examination Results follow. Both documents are also available on the web site of the Federal Financial Institutions Examination Council.

Examination Procedures: [www.ffiec.gov/cra/pdf/cra\\_exwhole.pdf](http://www.ffiec.gov/cra/pdf/cra_exwhole.pdf)

Sample Format for Public Disclosure of Examination Results: [www.ffiec.gov/cra/pdf/ex\\_instruct\\_w.pdf](http://www.ffiec.gov/cra/pdf/ex_instruct_w.pdf)



# Institutions with Strategic Plans Examination Procedures and Sample Format for Public Disclosure of Examination Results

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The Examination Procedures for Institutions with Strategic Plans and the Sample Format for Public Disclosure of Examination Results follow. Both documents are also available on the web site of the Federal Financial Institutions Examination Council.

Examination Procedures: [www.ffiec.gov/cra/pdf/cra\\_exsplan.pdf](http://www.ffiec.gov/cra/pdf/cra_exsplan.pdf)

Sample Format for Public Disclosure of Examination Results: [www.ffiec.gov/cra/pdf/ex\\_instruct\\_sp.pdf](http://www.ffiec.gov/cra/pdf/ex_instruct_sp.pdf)



# Community Reinvestment Act

## Sampling and Resubmission of CRA Data

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In August 2001, the Board adopted a uniform policy for the sampling and resubmission of data collected and maintained by state member banks, in accordance with Regulation BB. Although the sampling approach and data-resubmission policy are similar to those used for the verification and resubmission of data required to be reported under the Home Mortgage Disclosure Act,<sup>1</sup> there are two differences. First, the key fields are different.<sup>2</sup> Second, examiners will need to verify the accuracy of the CRA data aggregation for those banks that do not use the FFIEC data entry software for editing and reporting small business and small farm loan data.

As with the HMDA sampling procedures, the approach outlined in the “Data-Integrity Sampling Procedures” section of this chapter and illustrated by the “CRA Sampling Schedule” employs a two-tier sampling method that allows examiners in certain scenarios to stop their file review after a minimal number of files have been reviewed. For example, if the institution reported data for 150 loan files, the total number of files that should be randomly sampled during the exam is 56. The policy, however, allows examiners to review a smaller number of loans initially and subsequently decrease the sample size, provided that no more than 1 file in the initial sample contains errors in any key field.

For example, as noted in the CRA sampling schedule, for a universe of 150 files, the initial review would encompass 29 files. If, after completing the review of these 29 files, the examiner noted no more than one error in any key field for these files, the examiner should stop the file review. No additional files should be reviewed.

However, if the examiner finds that between 2 and 5 files have one or more errors in key fields, the examiner must continue reviewing the 27 additional files, for a total sample size of 56 files. After completing the review of the total sample of 56 files, the examiner should determine the total number of files that have key-field errors and apply the new

CRA data-resubmission policy (see the “Data-Resubmission Standards” section of this chapter) to the entire sample, if necessary.

If, however, in a universe of 150 files, the examiner finds 6 or more files that have an error or errors in key fields during the initial file review, the examiner should stop after completing a review of the initial 29 files. In this case, the findings based on the initial files reviewed would constitute sufficient statistical evidence to conclude that a larger sample would have an unacceptable error rate, thus requiring resubmission. At this point, the examiner should apply the CRA data-resubmission standards to the total sample.

After analyzing the errors found during the sampling process, examiners may choose to perform supplemental targeted random sampling. For example, after completing a review of a CRA sample, an examiner may discover that CRA data errors appear to be coming from one particular loan decision center or are most prevalent in a particular product type. The examiner might decide to select a supplemental random sample of loan records specifically tied to that loan decision center or loan product. In these instances, supplemental samples should follow the same sampling process as the original sample, utilizing the two-tier approach found in the CRA sampling schedule. The statistical validity of this approach relies upon review of a random sample from the data maintained at each bank, as well as on a review of information year by year (separate universes) and not combined into one universe.

*The following sections, “Data-Integrity Sampling Procedures,” “CRA Sampling Schedule for Data Accuracy,” and “Data-Resubmission Standards,” are based on attachments I, II, and III, respectively, to CA 00-2.*

### Data-Integrity Sampling Procedures

The following CRA data-integrity sampling procedures should be applied when reviewing data collected and maintained by state member banks, in accordance with the data collection, reporting, and disclosure requirements of Regulation BB:

1. *Identify and select the loan files to be reviewed.* For each CRA reporter, review applicable loan data for the current year and all other years since the last examination. The data collected and maintained for a single year constitute the universe from which a sample is taken. As a

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1. These procedures are outlined in CA 00-2 and in the “Data-Integrity Sampling Procedures” section of this chapter.

2. Key fields for CRA are

- For small business and small farm loans: the loan amount at origination, the loan location (MSA, state, county, census tract), and an indicator whether the loan was to a business or farm with gross annual revenues of \$1 million or less;
- For community development loans: the loan amount at origination or purchase and an accurate community development purpose, as documented in supporting loan files; and
- For consumer loans collected and maintained at the bank’s option: the loan amount at origination or purchase, the loan location, and the gross annual income of the borrower.



result, it may be necessary to select multiple samples.

2. *Determine the total number of files to be sampled from column G in the “CRA Sampling Schedule for Data Accuracy” table, based on the size of the universe.* (This table, which will be referred to as the schedule, can be found in the next section of this chapter.)
3. *Select the total random sample.* (Instructions for selecting a random sample are contained in attachment 1 to CA 00-2.)
4. *Review the initial number of files shown in column B of the schedule.*
5. *The examiner may stop the sampling process after review of the initial number of files is completed, if the results indicate that a very small number of files had errors in key fields.* (See footnote 2 for a description of the key fields.) Using the schedule, this number can be determined by referencing column C.

For example, if a CRA universe contains 150 files, a total random sample of 56 files should be taken. The examiner may initially begin file review on 29 files. If, upon completing review of the initial 29 files, the examiner finds no more than 1 file with any error or errors in key fields, the examiner may end the sampling process for that CRA reporter for that universe. The examiner may then reach a statistically reliable conclusion that the findings are indicative of the universe and resubmission<sup>3</sup> is not necessary.

6. *The examiner must complete a review of the total random sample of files if a larger number of files with errors in key fields are found during the initial file review.* The need for this additional file review can be determined by using the schedule and referencing column D titled “Number of files with errors—Additional file review required.” If the number of files that have errors in key fields from the initial review falls within the number reflected in this column, the examiner must review the additional files to complete the total random sample.

For example, if a CRA universe contains 150 files, a total random sample of 56 files should be taken. The examiner may initially begin file review on 29 files. If, upon completing review of the initial 29 files, the examiner finds 4 files with an error (or errors) in key fields, the examiner should then review 27 additional files, for a total sample size of 56 files. After completing review of the additional 27 files, the examiner should determine the total number of files that have key-field errors and apply the CRA data-resubmission standards to the total sample. (See the “Data Resubmission Standards” section of this chapter.)

7. *If an examiner determines that a large number of files reviewed in the initial file review have an error or errors in key fields, the examiner may stop the verification of loan data after the initial file review is completed and should apply the data-resubmission standards.* This maximum number can be determined by using the schedule and referencing column E. For example, if a CRA universe contains 150 files, a total random sample of 56 files should be taken. The examiner may initially begin file review on 29 files. If, upon completing review of the initial 29 files, the examiner finds 6 (or more) files that have an error or errors in key fields, the examiner should stop the file review. Sufficient statistical evidence has been obtained to conclude that a larger sample would have an unacceptable number of errors, thus requiring resubmission. At this point, the examiner should apply the CRA data-resubmission standards to the total sample.
8. *Determine the software used by the bank for editing and reporting small business and small farm loan data.* If the bank uses the FFIEC data entry software for editing and reporting small business and small farm loan data, no further review is needed. If the bank does not use the FFIEC software, verify the accuracy of the CRA data aggregation.

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3. For consumer loan data, the decision would not be whether to require resubmission but if the data collected and maintained are used as part of the CRA examination. If a bank elects to have consumer lending data considered during its CRA examination, the data must meet these accuracy standards. If consumer lending constitutes a substantial majority of a bank’s business, the examiner should evaluate the bank’s consumer lending in one or more of the categories specified in section 228.12(k) of Regulation BB (motor vehicle loan, credit card loan, home equity loan, other secured consumer loan, or other unsecured consumer loan) using loan files sampled by the examiner.

### CRA Sampling Schedule for Data Accuracy

A	B	C	D	E	F	G
CRA UNIVERSE	INITIAL FILE REVIEW				ADDITIONAL FILE REVIEW	TOTAL RANDOM SAMPLE
	Initial file review	Maximum number of files with errors*— Stop sampling	Number of files with errors*— Additional file review required (go to column F)	Minimum number of files with errors*— Stop sampling & apply resubmission standards		
1-12	Review all					
12-20	12	0	1	2	Review all	All
21-30	13	0	1	2	Review all	All
31-50	15	0	1-2	3	13	28
51-70	17	0	1-2	3	12	29
71-90	18	0	1-3	4	20	38
91-110	28	1	2-3	4	11	39
111-130	29	1	2-4	5	18	47
131-140	29	1	2-4	5	20	49
141-170	29	1	2-5	6	27	56
171-190	30	1	2-5	6	27	57
191-270	30	1	2-5	6	29	59
271-380	30	1	2-6	7	38	68
381-750	31	1	2-6	7	38	69
751-1100	31	1	2-7	8	48	79
1101-	32	1	2-7	8	47	79

\*Files with one or more errors in key fields. See footnote 2 for a description of the key fields.

### Data-Resubmission Standards

To ensure the integrity of the CRA data used for analysis, the following guidelines should be used when considering whether to have an institution resubmit CRA data.

Institutions should be required to correct and resubmit CRA small business and small farm data when at least 5.0 percent of the data collected and maintained in accordance with section 42(a) of Regulation BB were recorded incorrectly. The key fields covered by this 5.0 percent rule are

- The loan amount at origination,
- The loan location (MSA, state, county, census tract), and
- An indicator whether the loan was to a business or farm with gross annual revenues of \$1 million or less.

Institutions are required to correct the aggregate number and aggregate amount of community development loans originated or purchased if data for 5.0 percent or more of the number or amount of the underlying loans do not meet the definition of community development.

Rounding errors in the loan amount and income fields should not be counted towards resubmission.

In addition to basing a resubmission on the error rate for an individual field, if at least 10.0 percent of the institution's records have an error in at least one of the key fields, then the entire CRA file must be resubmitted. In this instance, the institution must verify the data in each of the fields and not just those with greater than a 5.0 percent error rate.



# Community Reinvestment Act Community Contact Procedures

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## General Guidelines

The primary objectives of conducting interviews with local community contacts are to

- Gather information that might assist in the development of a community profile;
- Determine opportunities for participation by financial institutions in helping to meet local credit needs;
- Understand perceptions on the performance of financial institutions in helping meet local credit needs; and
- Provide a context on the community to assist in the evaluation of an institution's CRA performance.

This section provides information and procedures for conducting community contact interviews. It broadly addresses a wide variety of subjects to accommodate varying communities and types of institutions. As a result, it is *not* meant to be used in the order presented. Examiners should select those steps and procedures that apply to the unique circumstances of the institution and/or the community.

## Coverage and Frequency of Community Contacts

Community contacts typically take the form of personal meetings. Telephone conversations or larger group meetings are permitted as necessary and appropriate. Information from other financial regulatory agencies is also available in electronic form. At least in conjunction with each examination, the [agency] will conduct community contacts in the MSA, county, or assessment area(s) that the financial institution in question is serving. When possible, those community contacts should be conducted early in the examination to help to provide a context on the community to assist in the evaluation of performance.

## Selection of Community Contacts

The number and nature of contacts will depend upon a variety of factors, including the complexity of the community, the size and type of the institution examined, and the amount and age of community-driven information already available to the examiner.

## Treatment of Confidential Information

### Confidentiality of Institution's Records

Examiners must maintain the confidentiality of any institution's proprietary information. When making community contacts, the examiner should not reveal any confidential information obtained from the institution's files or through discussions with management, or any conclusions drawn about the institution's performance or CRA rating.

### Protection of Community Contacts

Maintaining the confidentiality of the community contact's identity, when requested to do so, is essential. Examiners must not reveal the name or other identifying information about a community contact to anyone outside the agency without the contact's permission to do so.

## Report of Examination and CRA Performance Evaluation

Include in the Report of Examination and the CRA Performance Evaluation, as appropriate, a discussion of the number and kinds of CRA-related community contacts that were consulted and relevant information obtained and used, if any, in the CRA evaluation. Information should be factual. While opinions of contacts may be included when applicable, examiners should refrain from drawing conclusions or making judgments based solely on anecdotal evidence.

## Sharing Information

The agencies routinely share information obtained during outreach contacts. Whenever community contacts are made, the examiner initiating the contact should complete the Community Contact Form and submit it to the party designated within each agency. The designee will distribute copies of the form to their counterparts at the other regulatory agencies.

## Preparation for the Interview

Before conducting interviews, review relevant background information to identify additional areas of inquiry. Adequate preparation for the interviews includes reviewing information on the assessment area, selecting community contacts, and structuring the interview.

## Review of Information on Assessment Area

A review of all available background materials prior to the community contact process is vital in developing a working understanding of the community you are about to enter. The nature, extent, and age of the information available prior to conducting community contacts influences your objectives for the community contact process. A well-developed context also allows for more detailed and in-depth community contact interviews. The examiner should

- Assess prevailing economic conditions and demographic characteristics within and near the assessment area. This includes a review of available data on various population segments within the community, trends in migration, labor and employment characteristics, comparisons to state and county/MSA data, and housing and real estate market statistics.
- Assess infrastructural and geographic characteristics within the assessment area. This includes a review of maps; natural areas; major thoroughfares; access to public transportation; locations of low- and moderate-income census tracts; names of specific low- and moderate-income neighborhoods; and proximity of the assessment area to military bases, airport facilities, and metropolitan centers. Internal mapping software; information from the financial institution; and information from local planning, transportation, economic development, or real estate boards are good sources for possible information.
- Assess distribution and availability of branch and ATM services, especially with regard to low-income areas within the community. Include a review of check-cashing facilities, if possible. Internal mapping software, if available, can allow the examiner to map these locations.
- Assess, to the extent information is available, local development issues and priorities in the areas of affordable housing, commercial activity, and economic and community development.

A summary of such information may be available from the Community Affairs function. In addition, the examiner may wish to review previous community contacts for this locality, including those from other regulatory agencies. If the examiner is reviewing an MSA, he or she should contact the city's municipality and obtain a copy of its Consolidated Plan (Conplans). Conplans list the needs of an MSA as identified and prioritized by its officials. The examiner may also consider obtaining public reports from multiple listings services (MLS) and news articles on local development projects.

Quantitative sources may include feasibility studies, market analysis, or commercial appraisal reports for local development projects. State or local economic development agencies, utility companies, real estate organizations, and universities present in the immediate or surrounding area are often good sources for such material. Section II, "Identification of Potential Contacts," contains additional potential sources for these types of material.

- Determine the priorities of the community and the opportunities for financial institutions to participate with local governmental and nonprofit organizations in the areas of affordable housing, small business/farm development, and economic and community development. Review the number and nature of government agencies, nonprofit, and neighborhood organizations that provide programs and resources to the assessment area for these purposes. If possible, note the amount of funds devoted to these purposes. Also, attempt to determine which programs or organizations are particularly active with respect to the low-income individuals and/or areas located in the assessment area.

Sources of information for this step include prior community contacts in this area, information on local programs from the institution, and discussions with appropriate agency staff.

- Based upon information reviewed, above, identify areas that require further inquiry through the community contacts process. For example
  - a. Are there any significant conflicting pieces of information that may require further investigation in the contact interviews?
  - b. Are there any pieces of quantitative information, such as housing and rental values, that are considerably outdated and need to be verified in the contact interviews?
  - c. Do the data suggest particular areas of "need" in affordable housing, such as housing rehabilitation, multifamily development, or single-family home purchase, that you can investigate further and verify through the contact interviews? Or alternatively, are needs for specific areas of the population, such as housing for the elderly, still unclear and therefore require further study through the contact interviews?
  - d. Do the data suggest particular areas of need in services, such as ATMs, branches, or bilingual services, that can be investigated further and verified through the contact interviews?
  - e. Does the review identify organizations or projects requiring additional information?

## Identification of Potential Community Contacts

This section discusses the number of types of community contacts that should be made during an examination. It also identifies potential community contacts and provides guidance on the sources of information that are available from them.

### Number and Type of Contacts

Select contacts that can best provide information on the assessment area(s). Consider the nature of the information you are seeking to complete your analysis of the assessment area(s) and the purpose of the organizations in the assessment area(s). Examiners may wish to initially consult or select organizations on the telephone to determine which can best comment on particular issues.

Time constraints can limit the number of contacts that the examiner is able to conduct. The following factors may be considered when determining the appropriate number of contacts to make:

- The nature of any information provided by the institution, including information that specifies credit, service, or community development needs in the institution's assessment area
- The nature of public comments, including information that specifies credit, service, or community development needs in the institution's assessment area
- The amount of community contact information available from other examinations conducted for this area, both in number and substance, and the date the information was gathered
- The complexity of the community, including the size of its population, its geographic breadth, and the diversity of its population
- The characteristics of the institution examined

### Organization Types

#### 1. Grassroots Community Groups

Grassroots groups are formed when concerned individuals come together to solve common problems. Groups whose primary aim is to further the objectives of low-income residents are of particular interest. These groups can be difficult to identify because they tend to be smaller neighborhood groups and may not have readily recognizable names. However, they will often share the following characteristics:

- Low-income representation is evident in policy and implementation aspects of organization. This may be evident at the board level, in the committee structure, or in the day-to-day management.

- Input from low-income residents is clearly sought in functional/program aspects and information distribution to low-income individuals is a priority. Examples of this include door-to-door surveys and frequent neighborhood meetings.
- Low-income individuals are encouraged or empowered to solve problems collectively.

*Types of organizations:* Churches, block clubs, tenants associations, low-income advocacy groups, housing or credit counseling programs, senior citizen groups, shelter providers, health clinics, and community network/collaborative groups.

*Types of information available:* Development priorities and concerns of the local low-income populations; available development programs and resources; current partnerships and/or development projects in the area; and the role of financial institutions in the assessment area.

*Secondary information:* Completed questionnaires or surveys.

#### 2. Community-Based Development or Financial Intermediaries

The primary aim of these organizations is typically to increase the economic standard of low-income individuals or areas. Thus, they tend to be involved in technical aspects of development, such as residential and commercial real estate ventures or financing. Though these groups encourage representation of low-income individuals, they are also likely to have a higher degree of staff or decision-makers who live outside of the low-income areas that the organization is serving.

*Types of organizations:* Nonprofit organizations, such as community development corporations (CDCs); church-based economic development programs; community loan funds; small business investment corporations (SBICs); specialized small business investment corporations (SSBICs); low-income housing organizations; technical assistance providers, low-income credit unions; development institutions; and micro-enterprise groups.

*Types of information available:* Low-income credit, service, and community development issues at the neighborhood level; quantitative information on housing values and actual real estate projects; qualitative information on financial institutions and financial practices of low-income individuals; technical details on financing and lending mechanisms for programs they offer; and information on other government and program resources or ventures in the community.

*Secondary information:* Feasibility studies, appraisal information on specific neighborhoods, local needs assessments, surveys of institutions' activ-

ity, surveys of financial practices of low-income clientele, and lending agreements by groups of local financial institutions.

### 3. Government Offices

*Types of organizations:*

- Local branches of federal agencies, such as the Department of Housing and Development (HUD), Small Business Administration (SBA), Department of Commerce Economic Development Administration (EDA), Farmers Home Administration (FmHA), Bureau of Indian Affairs (BIA), and U.S. Department of Agriculture (USDA)
- Local groups of federally funded or mandated programs: community action agencies (CAAs), neighborhood revitalization programs, and Office of Minority Business Enterprise (OMBE) business development centers
- Local elected officials: mayors, commissioners, tribal chiefs, city council members, and tribal council members
- State and local housing agencies or authorities
- Economic development agencies, including industrial and redevelopment agencies or authorities, county or regional planning agencies, transportation agencies, utility companies, rural electric cooperatives, economic development corporations (EDCs), and local planning or economic development directors
- School board superintendent and officials

*Types of information available:* Types of loan, grant, guarantee, or other programs available for use by institutions and housing, community, and economic development groups; the amount of funding available through such programs in the institution's assessment area(s); the extent to which local financial institutions participate in such programs and perspectives on barriers or issues related to their participation; specific project opportunities in which institutions could participate; and information on underserved neighborhoods or areas.

*Secondary information available:* Housing, small business, agriculture, and general economic conditions and trends in the assessment area; publicly sponsored comprehensive or general development and redevelopment plans and maps; other plans and studies, such as housing plans (e.g., the Consolidated Plan), economic development plans, and studies; and various community service needs in the assessment area. School boards can update census information by providing demographic

information on the makeup of their student body. This information is typically collected annually.

### 4. Business and Labor Groups

*Types of organizations:* Chambers of commerce, downtown and neighborhood merchants associations, small and minority business advocacy groups, realtors, minority and nonminority real estate agents, local venture capital companies, SBA/college-supported small business development centers (SBDCs), feed stores, cattlemen's associations, actual small business owners, and small business technical assistance providers (such as business incubators and local union representatives).

*Types of information available:* Data and perspectives on local business, economic conditions, recent economic activity, and trends in the community; the nature and extent of small business activity; the level of referrals from financial institutions to SBDCs; the existence of active SBA 504 programs, or SBIC or SSBIC programs; perspectives on financial institution efforts to provide financing and services to small businesses/small farms; the level of institution participation in other public/private programs for small business development and employment training; and other private and public sources of financing available for small businesses and small farms in the assessment area.

*Secondary information available:* Mortgage interest rate sheets from financial institutions or mortgage companies obtained from realtors.

### 5. Civil Rights and Consumer Protection Groups

*Types of organizations:* Open housing/fair housing organizations; local chapters of the National Association for the Advancement of Colored People (NAACP), Urban League, Urban Coalition, and National Organization of Women (NOW); legal aid/legal services offices; human relations commissions; and state attorney general or consumer protection offices.

*Types of information available:* Credit needs, issues, or priorities for any protected classes; complaints against specific financial institutions; and general perspectives on financial institutions in the assessment area.

*Secondary information available:* Studies using testers in financial institutions, formal complaints, or case write-ups.

## 6. Other

*Types of organizations:* Universities, research institutions, foundations, and hospitals or hospital extension programs.

*Types of information available:* Many and varied. Specific community projects by universities or hospitals may be involved.

*Secondary information available:* Demographic and economic data; independent research studies or reports on community development topics; and studies and data collection on development and economic trends or opportunities in the area. Automated “Conplans” may also be available.

## Conducting the Interview

Having determined the groups and/or individuals to be contacted and the information to be solicited from each interview, the examiner must then plan the structure and content of questions prior to the interview. This section provides a sample list of questions that the examiner may wish to consider. The examiner should select and tailor questions from the list of sample questions that would be the most effective for each specific contact.

The questions highlight the type of information that the examiner is seeking through the community contact process. They are meant to serve as a guide to assist the examiner in planning the substance and structure of the interview. Obviously, not all questions will be appropriate to each specific contact. Nor is the list all-inclusive; particular questions may generate significant discussions and examiners are expected to probe and conduct follow-up questions appropriately. Examiners are encouraged to review the entire list before structuring their interview. As examiners gain experience, they are encouraged to engage in discussion with the community contact and not undertake a “question and answer” format.

## Background Information on Community Contact

The examiner should ascertain the organization’s area of expertise and the role that it plays in the community.

### *General:*

- a. What geographic areas does the organization serve?
- b. How old is the organization? How was it started? How much involvement by local residents and/or low-income residents was there initially?

- c. Whom does the organization represent? Roughly what percentage of your client base is very low- (defined as 25–50 percent of median area income), low-, moderate- or middle-income?
- d. What are the mission and the primary goals of this organization? What are the goals for this year?
- e. Is there a board of directors? What is the representation on the board? Are there low-income neighborhood residents on the board? Are banks/lenders or other financial institutions on the board?
- f. What projects or programs are you currently working on? Aside from programs, are there other means in which the mission is carried out?
- g. How many “clients” does this organization serve on a monthly or annual basis? If the organization is involved in development, how many real estate projects have been completed in the organization’s history? How many are ongoing?
- h. If direct loans have been provided through any programs, what type of loans are they? What segments of the community have benefited from these loans (low-, very low-, or moderate-income; the elderly; etc.)? What is the number and dollar volume of loans generated?
- i. What are the amounts and sources of the organization’s funding? How is the funding disbursed (i.e., what activities does it fund and how much of the budget is devoted to each activity)?
- j. Could you list the organization’s major accomplishments in the past five years? Is there such a list that you may have for purposes of your funders or funding proposals that I may have a copy of?
- k. What are some of the limits the organization is facing in serving its community? In what areas is it currently encountering opportunity?
- l. Is the organization interested in expanding its program or project areas at this time? In what area? Is there a timeline in place to implement these activities or expected to be in place?

### *Specific to Economic Development Agencies (Including Utility Companies):*

- a. Are there empowerment zones (EZs), enterprise communities (ECs), or foreign trade zones (FTZs) in your area? Where? What types of monetary incentives are offered?
- b. What are examples of small business, small farm, and community-based development that the agency has been involved in? Has activity



been concentrated in a few areas? Which ones?

- c. Does the economic development agency also coordinate the housing program and monies for this jurisdiction? If not, is economic development coordinated with housing officials? What priority is accorded to affordable housing? What priorities, if any, are accorded to specific population segments (e.g., elderly, special assistance, female heads of households, homeless, other)?
- d. Are the economic development strategies or the availability of the programs communicated to local residents in any way? How? [Note to examiner: Did you find that local residents or community representatives were able to articulate strategies or various programs?]
- e. Does the agency have working relationships established with community organizations at the neighborhood level? Who? What are the names of the individuals that the agency has worked with? If so, what is the extent of the partnership that has been established?

#### *Specific to Local Government:*

- a. What is the structure of the local government? Is there an economic development department? Is this separate from housing development?
- b. Which department has responsibility for economic development policy?
- c. Does the local government have programs that target affordable housing, small business development, and/or community development projects? How much funding do they have?
- d. Has the local government identified priorities for its housing and economic development funds? Has the government determined what impact this will have for the population (e.g., for the elderly, low-income families, individuals with special needs, the homeless)? To the agency's knowledge, what has been the impact of its funds in the last several years?
- e. How much money has been allocated for affordable housing, elderly needs, special needs, etc.? What is the time frame for the disbursement of funds, particularly CDBG funds?

#### *Specific to Real Estate Brokers:*

- a. Do you have brokers who specialize in low- or moderate-income housing (single or multifamily)?

### Obtaining a Community Profile

One of the primary objectives of the contact

process is to update the community profile. The examiner is expected to obtain and update information on current economic conditions and trends, current demographic characteristics, and existing credit needs.

#### *General:*

- a. What is the current demographic makeup of the community? What were the most significant demographics changes in the past five to ten years, if any (e.g., migration patterns, racial composition)?
- b. Which neighborhoods are in transition, if any? Has gentrification or the displacement of low- or moderate-income individuals become an issue in certain neighborhoods? In which neighborhoods? Is the potential displacement of individuals being managed in some process, for example, a relocation package? If so, how and who is involved?
- c. What major employers have either entered or left the community in the last few years? Has this impacted certain categories of the labor market and not others? If so, who was positively impacted? Negatively? How?
- d. Who or what organizations are the driving forces in the community (examples include churches, government, community groups, etc.)?
- e. What priorities have you identified for this area?
- f. Have you conducted any studies (e.g., neighborhood surveys or feasibility studies) that may provide insight into local credit, service, or community development needs? What were the results? (Obtain a copy, if available.) How was the study used and what was the distribution (any banks included)?
- g. Do zoning restrictions play a role in the availability of affordable housing units? How? Which neighborhoods are most impacted?
- h. Are absentee landlords a problem? For whom? In which neighborhoods?
- i. In your opinion, what credit needs have not been adequately satisfied by area financial institutions? (Give example: small business loans, home improvement loans, installment loans, etc.)
- j. To what extent are financial services available in the assessment area? What is the availability of ATMs or branches in this neighborhood?
- k. Are there many women- or minority-owned businesses in the area? If so, are they concentrated in any geographic location or occupational field?

*Specific to Community-Based Organizations*

- a. Does this community have a significant number of people who would be “uncounted” in official census figures? If so, why? Does your organization give estimates of the uncounted or real population?
- b. What are the primary and secondary issues that low-income people in this area are concerned with in the short term? In the long term?
- c. What are the most pressing concerns—e.g., adequate housing, access to retail goods, adequate public transportation facilities, adult education, job training and placement, English as a second language (ESL), health facilities—that you have been able to identify facing low-income residents?
- d. What language(s) are spoken in the community?

*Specific to Economic Development Agencies (Including Utility Companies):*

- a. What are the primary economic strengths of this area? Primary weaknesses? (Note: Economic development agencies typically operate at the county or MSA level. Using follow-up questions and probing techniques, attempt to get as local an assessment as possible.)
- b. Are there development plans currently underway for infrastructure-related projects, such as bridges, sewers, etc.? If so, what is the suggested timetable? Will the project generate or is it generating jobs for low- or moderate-income residents?
- c. What are the main economic development strategies (examples include business attraction, business retention, marketing, small business development, etc.) that you are currently pursuing for the overall county or MSA? For a particular neighborhood? What priority is given to small business, small farm, and community-based development (such as grocery stores, day care facilities, etc.)?

*Specific to Housing Organizations (State, Local, Etc.):*

- a. What is the waiting list for various affordable housing programs in the area?
- b. Have you received complaints from tenants that buildings are not in compliance with local building codes? In your perception, how widespread is this problem?
- c. What is the nature of demand for affordable housing? How does this compare to available housing stock, both in terms of number of units

and types of units?

- d. How would you rate the need for housing among various sectors of the community, such as the elderly, individuals on special assistance, female heads of households, the homeless, others?
- e. Are there structural inadequacies in the type of housing stock available for low-income populations in this area? Is housing rehabilitation a priority issue among those your organization has identified?

*Specific to Real Estate Brokers:*

- a. (Refer to specific geographic areas.) What are the current economic conditions in this general area? Are housing values going up or down? If it is an “up” market, what are some of the forces contributing to its success? If down, what are some of the issues contributing to its decline?
- b. Has there been any recent development activity in this area? What is the nature of the development (commercial, residential, affordable housing, public projects)? What has been the impact on the neighborhood?
- c. Are there mobile homes or concentrations of mobile homes, such as mobile-home parks, in any area?
- d. What is the average length of time that single-family homes are on the market in this neighborhood?
- e. Other types of residences? Other neighborhoods?
- f. Do you know of any changes in the near future that would impact the market for residential/commercial properties in a specific area? What are these changes (political, environmental, legal, etc.)?
- g. Do you have copies of any appraisal reports for commercial and residential properties? For which areas (obtain, when possible)?
- h. Are you aware of appraisal-related problems in this neighborhood, such as the lack of comparables?
- i. What credit products do your customers typically use to purchase a home? Conventional mortgages? Government loans? Land contracts? Why?
- j. What are the various sources of financing that your customers typically use? Banks? Thrifts? Mortgage companies? Home improvement dealers? Credit unions? Employer-related sources (i.e., GMAC)? Others? Are particular combinations of sources more typical than others?
- k. What are the characteristics of likely investors

for multifamily housing properties in a specific neighborhood? What are the likely financial risks and rewards for investors in this area? (Compare with other neighborhoods.)

*Specific to Foundations:*

- a. What types of eligibility criteria are currently established for community development programs?
- b. Which organizations and projects do you fund? How much money is committed to these organizations and/or projects for this year?
- c. How long is the money committed for?
- d. Out of the programs and/or organizations that you funded in this area, which are the most effective in the affordable housing area? In the small business development or community development area?

### Assessing Opportunities for Financial Institution Participation

The degree to which financial institutions are involved in community development projects or services depends in some part on the extent of other resources and partners available within the community. Examiners are expected to obtain information on the availability of resources dedicated to the local credit or development needs that have been identified. Examiners are also expected to gauge the level of the contact's efforts in approaching local financial institutions and the mechanisms of any financing involved, if any.

In addition to any background materials reviewed in the preparation portion of the examination, contacts can provide relevant information on

- The number and nature of community development or credit-related projects being developed for the benefit of the community,
- The number of organizations or government programs committed to those activities,
- The extent to which partnerships or other forms of coordination are evident in the area,
- The level of resources devoted to these activities, and
- How active these programs or resources are with respect to promoting the credit or banking needs that local representatives or residents have identified.

*Community-Based Organizations:*

- a. Has your organization ever participated in activities, either formally or informally, with financial institutions? If so, which ones? For

what projects or products? For what clients (e.g., what were the income characteristics of those who benefited)?

- b. Does your organization partner with other groups, including religious organizations, government agencies, and neighborhood organizations, in conducting any of its program activities?
- c. Tell me about any other organizations you work with in meeting your clients' needs. What other organizations serve this community in the areas of affordable housing? Small business development? Commercial, day care, or other community-related facilities? Job training? Credit counseling? Low-income advocacy?
- d. Which of these organizations do you consider most active? If I wanted more information from them, whom should I contact?
- e. Which financial intermediaries do you consider particularly effective? Why?
- f. Are you seeking funds from local financial institutions for any current projects?
- g. What is the nature of the project? Is it a development-based product? Is it related to credit needs in the community? Is there a specific neighborhood or group of individuals that this project will benefit? How?
- h. What are the specific requirements for the financing that you are seeking?
- i. Are you aware of similar projects that other organizations are working on? What can you tell me about those? Whom can I contact to learn more?

*State and Local Economic Development Agencies, Government Agencies:*

- a. What, if any, commercial development projects are underway? Where are they located? Are jobs created? Will low- or moderate-income individuals benefit? How?
- b. What are the number and nature of various economic development programs funded by the city or state? How many residents do these programs benefit annually?
- c. Which of these programs, if any, are designed to leverage funds from financial institutions? What are the mechanics of the program? How many projects have been funded to date? Which financial institutions have participated in these programs? Is there a particular area or group that these funds target?
- d. Do you have programs designed specifically for affordable housing or small business development? If so, how many small businesses and/or

small farms benefit? What is your definition of small business?

- e. What are the funding levels of these programs? How many projects have been funded to date? Is there a particular neighborhood or group that these funds target? If so, what are they?
- f. Have any financial institutions participated in these programs? If so, which ones?
- g. Do you currently have other projects or have you had projects in the past that required either investment or other forms of financing from a financial institution? What are/were the characteristics of the project? Its financing? Include projects involving bond issuances, etc. What were the results? Innovative? Risky?
- h. What financing mechanisms are needed, planned, or in place for any development or infrastructure-related projects?

#### *Real Estate Brokers:*

- a. Do you know about local or state financing programs for affordable housing, small business, or commercial development? How did you hear of these programs?
- b. Are there specific home insurance or financing programs that you utilize or to whom you refer customers? Which ones? Which do you utilize specifically for your low-income customers?
- c. Which financial institutions in the area are you aware of that access these programs? How actively? Which do not?

#### Obtaining Local Perspectives on the Performance of Financial Institutions

In addition, another function of the community contact process is to obtain feedback from the community on the performance of local financial institutions. The examiner is expected to gather information on the willingness and responsiveness of financial institutions, including the institution under examination, to work with local residents and professionals in meeting credit and community economic development needs.

#### *General:*

- a. With which banks, savings and loans, or mortgage companies have you been involved? What was the nature of your involvement?
- b. Has your organization ever participated in activities, either formally or informally, with financial institutions? If so, which ones? How did this professional relationship develop?
- c. What were the results of your involvement with

financial institutions? In what ways has financial institution participation had a positive impact? In what ways has it had a negative impact? Probe for such project aspects as timing, financing terms, etc.

- d. Are local financial institutions proactive in developing relationships or offering assistance? If so, which ones?
- e. What financial institution(s) does your group recommend to your constituents? Why?
- f. What obstacles, if any, prevent greater involvement from financial institutions in meeting local credit needs?
- g. Have you ever been invited by institutions to participate in institution-sponsored activities? If yes, specify the activities' purpose and the role you played.
- h. Has your organization ever received complaints about individual institutions?
- i. Did the people affected know about the complaint process or were they informed about it?
- j. Did any of the complaints involve allegations that the institution(s) discouraged people from submitting an application? Did any complaints involve geographic or racial redlining, or any other forms of discrimination? What happened?
- k. Is anyone in your group or known to your group willing to offer specific evidence of discriminatory actions by specific institutions? (If allegations of discrimination, discouragement, or redlining are made with respect to an institution regulated by your agency, forward the relevant information to the institution's primary regulator.)
- l. In your opinion, which institutions in the area have been particularly outstanding in meeting the community's needs? Why? What, specifically, has been done by these institutions?
- m. In your opinion, which area institutions have been particularly notable for their unwillingness to respond to the community's needs? Why?
- n. In your opinion, how well does [institution name] meet the credit needs of this community?

#### *Community-Based Organizations:*

- a. Have you discussed local credit needs with any financial institutions? What were the results?
- b. Do any institutions provide in-kind services, i.e., loaned executives, etc.?
- c. What efforts are made to inform institutions and obtain their participation in the organization's activities? Which institutions participate and to what degree? Which institutions, if any,

declined to participate?

- d. If your organization works with government enhancement programs, do financial institutions work with you on that product? If so, which ones?
- e. What efforts have you employed to improve your organization's relationship with any institutions? Which institutions? How successful have your efforts been?

*Real Estate Brokers:*

(Be sure to include those operating in low- or moderate-income areas.)

- a. Do you frequently work with financial institutions or other lenders that originate home mortgages?
- b. Which institutions do you receive rate sheets from on a consistent basis? How are they typically delivered to you?
- c. Are local lenders willing to work with you for first-time homebuyers? If so, which ones? Why or why not?
- d. Are local lenders willing to work with you on exceptions on credit reports? If so, which ones? Why or why not?
- e. What knowledge, if any, do you have of credit standards being adjusted in either a preferential or discriminatory manner? Which lenders? What were the circumstances?
- f. Have you worked with lenders that have taken customers under the Fannie Mae 97 percent program? Freddie Mac? Others?
- g. Which lenders do not receive your referrals for home purchases and why? Which lenders do

not receive your referrals for small businesses and why?

- h. What percentage of referred homebuyers normally go to the recommended lenders?
- i. What percentage of referred homebuyers normally get loans from recommended lenders?
- j. What other methods could be used to increase the use of insured financial institutions by people in your market area? In particular, are some financial institutions attracting portions of the market and not others? For which products?
- k. Do women or minorities have more difficulty than men in obtaining mortgage loans? If so, why? Which institutions are perceived as not meeting the needs of women or minority applicants?
- l. Are there outreach activities by particular institutions for women or minority customers? Do you perceive these programs as positive?
- m. In your experience, are there certain institutions favored in the minority and/or women's business community?

*Business, Labor, or Consumer Groups  
Working with the Women's or Minority  
Business Community:*

- a. What is the general perception of financial institutions in the minority business community? In the women's business community? Why?
- b. Do any financial institutions have a small business department targeting women or minorities? Which ones? How is it done?
- c. Which institutions have separate minority or small business counseling services? Do the counselors also have lending authority?

# Community Reinvestment Act FFIEC Community Contact Form

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Examiners should summarize each interview they conduct on the Community Contact Form. The purpose of this form is to provide a consistent means by which financial institution regulators can share information obtained through interviews for a particular community. The individual conducting the interview should inform the interviewees that this information will be shared with other regulatory agencies.

1. Regulatory agency:

2. Date of contact:

3. Interviewee information:

Name: \_\_\_\_\_ Title: \_\_\_\_\_  
Organization represented:  
Type/organization category:  
Address:  
City: \_\_\_\_\_ State: \_\_\_\_\_  
Interviewee's telephone:  
Add area served:  
Served state(s): \_\_\_\_\_ Served MSA(s): \_\_\_\_\_ Served counties: \_\_\_\_\_

4. Was this the first contact with this organization (in connection with a current examination) or a follow-up contact?

First \_\_\_\_\_ Follow-up \_\_\_\_\_

5. Was the interview conducted in conjunction with an examination? If yes, list financial institutions.

Institution name \_\_\_\_\_ Cert \_\_\_\_\_ Charter \_\_\_\_\_ Docket \_\_\_\_\_ RSSD \_\_\_\_\_

6. Summarize the organization's purposes, functions, and sources of funding. Include the organization's impact if applicable (for example, number of low-income clients served, number of units built, etc.).

7. Political or geographic boundaries of area focused on during this specific contact.

8. Interview summary.

(a) Community profile:

*Current economic conditions; current demographic characteristics; general banking and credit needs; other (e.g., identifying names of low- or moderate-income neighborhoods).*

(b) Opportunities for participation by local financial institutions:

*Community development, other credit-related projects, or financing programs; level of opportunity for bank involvement.*

(c) Performance of local financial institutions:

*Perceptions or experience regarding the degree of involvement of the local financial institution industry and of the specific financial institution (if obtained) in the community.*

9. Person in charge of examination:

Interviewer:

Reviewed by:



# Community Reinvestment Act Instructions for Writing Public Evaluations

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The format of all of the public evaluation templates follows the provisions of amendments to the Community Reinvestment Act that require the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation (agencies) to

1. Rate the institution's overall performance in meeting the credit needs of its community;
2. For an interstate institution, rate each state in which the bank has branches or multistate metropolitan statistical area (MSA) in which the institution has branches in more than one state; and
3. Separately present the conclusions for the performance test(s) or criteria considered in arriving at the rating as well as the facts and data supporting those conclusions for each MSA in which the institution has branches.

The contents of the public evaluation will vary depending on the nature of the institution examined and the examination method used. Public evaluation templates for small institutions, intermediate small institutions, large institutions, wholesale and limited-purpose institutions, and institutions operating under approved strategic plans have been prepared by the agencies. These templates provide guidance regarding the structure and contents of the public evaluations. Except for the intrastate public evaluations for small institutions and intermediate small institutions, the templates are structured to meet the requirements that the CRA imposes on public evaluations for interstate institutions. The samples can easily be adjusted to suit the requirements for institutions with branches in only one state.

## Evaluations for Institutions with Branches in Only One State

Regardless of the examination method used, the public evaluation for institutions with branches in only one state must contain the institution's overall CRA rating and the conclusions for the performance test(s) or criteria upon which the rating is based. No state or multistate MSA rating is needed for intrastate institutions. Also, there is no requirement to rate an institution's performance in each assessment area. Rather, the public evaluation must present conclusions about the institution's performance in the assessment area(s) subject to the following guidance:

1. If the institution has branches in more than one MSA, the public evaluation must present the conclusions for each performance test(s) or criterion, along with supporting facts and data, separately for each MSA.
2. If the institution has defined more than one assessment area within a nonmetropolitan statewide area, separate discussion of CRA performance within a nonmetropolitan statewide area for intrastate institutions that have branches in metropolitan and nonmetropolitan areas is optional because the performance in the nonmetropolitan areas has been discussed in the overall evaluation of the institution. Examiners may wish to discuss in greater detail, however, the assessment areas within the nonmetropolitan statewide areas that were reviewed using the examination procedures for (1) intrastate institutions with branches in MSAs or nonmetropolitan areas or (2) intrastate institutions with branches only in only nonmetropolitan areas.

More-detailed discussions of each assessment area examined should follow the appropriate MSA and nonmetropolitan-area presentation.

## Evaluations for Interstate Institutions

In addition to the institution's overall CRA rating, public evaluations for interstate institutions must contain ratings for each state in which the institution has branches and multistate MSA in which the institution has branches in more than one state of the multistate MSA. The public evaluation for interstate institutions is, therefore, organized to present the institution's overall rating first, followed by the multistate MSA rating(s), and then the state rating(s). The discussion of the overall institution, multistate MSA, and state ratings must include the conclusions for the performance test(s) or criteria upon which the rating(s) is based. An institution's performance in each assessment area is not rated. Rather, the public evaluation must present the conclusions about the institution's performance in the assessment area(s) subject to the following guidance:

1. Multistate MSA presentations should be followed by discussions of the performance within assessment area(s) within the multistate MSA.
2. Separate MSA presentations for each MSA where the institution has branches should follow the appropriate state presentation. A discussion of an institution's CRA performance within a nonmetropolitan area statewide area is required



for institutions with branches in two or more states. Include a discussion about how the examination of the institution was performed, including a list of the individual branches examined.

Again, more-detailed assessment-area discussions should follow the applicable MSA and nonmetropolitan-area discussions.

## Conclusions Based on Performance Tests

The CRA requires the agencies to present conclusions for each of the performance test(s) or criteria considered in arriving at a rating. The performance evaluations should reflect the conclusions reached under these performance tests.

- For large institutions, the public evaluation must indicate the conclusions reached under the lending, investment, and service tests.
- For intermediate small institutions, the public evaluation must indicate the conclusions under the lending and community development tests.
- For small institutions, the streamlined assessment method for small institutions focuses on lending performance. However, to the extent that investment and service performance were considered in rating a small institution Outstanding, the conclusions for each must be in the public evaluation.
- For wholesale and limited-purpose institutions, conclusions for the community development test must be discussed in the performance evaluation.

- Finally, for institutions that operate under an approved strategic plan, the performance evaluation for those institutions must contain conclusions for the tests used in the examination.

## Hybrid Performance Evaluations

When an institution is examined under more than one examination method, the examiner should develop a hybrid performance evaluation. The evaluation should state the examination methods used in the “General Information” section. In addition, the discussion of the scope should indicate the examination method that was used in each assessment area examined. Finally, discussions of the analysis used under each assessment-area presentation should note the applicable examination method.

## Charts, Tables, and Appendices

Charts and tables should be used throughout the public evaluation to facilitate discussion of the institution’s performance. In addition, the inclusion of one or more appendices may facilitate the presentation of information in the public evaluation. For example, appendix A is a chart describing the scope of the examination and should be used for institutions with numerous assessment areas. Appendix B should be used to summarize the state ratings for interstate institutions. Other charts and tables may be used to assist the reader and amplify the discussion of an institution’s performance.