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## *Consumer and Community Affairs*

In 1996 the Board moved to administer major changes under revised inter-agency regulations to carry out the Community Reinvestment Act (CRA). On January 1, small banks became subject to examination under the new rules; large banks began data collection and in some instances began developing strategic plans as the measure of their CRA performance. The new rules, issued in 1995, emphasize performance in lending, service, and investment and will help promote consistency in assessments and reduce compliance burdens for many banks.

The Board acted on a large number of bank and bank holding company applications that involved CRA protests, adverse CRA ratings, and issues of fair lending and noncompliance with consumer regulations. Several applications involved major bank mergers that elicited strong support and opposition from members of the public, and all were protested on CRA grounds. The Board approved them after extensive analyses, finding in each case that convenience and needs factors were consistent with approval.

In the fair lending area, the Board referred discrimination cases regarding state member banks to the Department of Justice and also forwarded the results of a major investigation into a mortgage lender's overage-pricing practices. The Board referred other cases, which raised claims of alleged mortgage discrimination, to the Department of Housing and Urban Development (HUD) for investigation. The Board continued to improve the System's examination process for fair lending, using enhanced statistical

techniques to test large institutions for compliance.

Acting on behalf of the Federal Financial Institutions Examination Council and HUD, the Board met statutory deadlines with the early release of Home Mortgage Disclosure Act statements for individual lenders and aggregate reports for metropolitan areas. From the data, the Board noted a marked increase in lending to minority and low-income homebuyers, although denial rates continued to show disparities among racial and ethnic groups.

Subsequent to multiyear reviews of Regulation M (Consumer Leasing) and Regulation E (Electronic Fund Transfers), the Board completed rulemakings that better match its consumer regulations to industry developments. In other rulewriting, the Board published two proposals, one governing "self tests" that lenders may conduct under Regulation B (Equal Credit Opportunity) to determine their compliance with fair lending laws and another raising the threshold for the coverage of small institutions under Regulation C (Home Mortgage Disclosures) based on asset size; the two proposals implement amendments to the Equal Credit Opportunity Act and Home Mortgage Disclosure Act respectively.

These matters are discussed below, along with other actions by the Board in the areas of community affairs and consumer protection.

### **CRA Reform**

During 1996 the Board began its implementation of a revised regulation under

the Community Reinvestment Act, working closely with the three other financial supervisory agencies that have CRA responsibilities (the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision). The revised regulation provides more direct guidance to banks and thrift institutions on the nature and extent of their CRA responsibilities and the means by which those obligations will be assessed and enforced. It creates a more quantitative system for assessing CRA performance that includes reviewing data on the institution's lending, service, and investment activities; requires larger institutions to collect additional data for loans to small businesses and small farms; and allows alternative bases of evaluation for certain institutions to minimize the regulatory burden.

During 1996 the agencies began using new examination procedures designed to make the examinations for small institutions less intrusive and more focused on performance. In addition, a small number of banks elected to be examined under the revised regulation's lending, investment, and service tests.

The Board approved a strategic plan submitted by a state member bank for defining its program for addressing CRA responsibilities, as provided by the regulation. Further, three banks were granted designation as wholesale institutions under the revised regulation and two were designated as limited-purpose institutions.

Some measures taken by the Federal Reserve will assist in implementing the new CRA rules. A software program was developed that assists examiners in choosing a statistically reliable sample of loans for review; another program prepares summaries of demographic and economic information for use in CRA examinations. In addition the Board,

in conjunction with the other federal supervisory agencies, issued a document that addresses many of the questions more frequently encountered under the new regulation. The agencies anticipate adding to this document over time as new questions arise and are addressed.

### **Fair Lending**

Under the Equal Credit Opportunity Act (ECOA), the Board is required to refer to the Department of Justice violations that it has reason to believe constitute a "pattern or practice" of discrimination. The Board made five referrals during 1996, three related to race discrimination and the others to marital status violations. Two of the cases involving alleged race discrimination were under active investigation by the Department of Justice at the close of 1996. After review, the three remaining matters were returned for enforcement by the Board.

Also in 1996, the Department of Justice reached a court-approved settlement agreement with a lender on a matter referred by the Board in late 1995. The Board had forwarded information from a major investigation of loan pricing involving "overages" that were allegedly discriminatory. In the settlement, which was based on evidence developed by the Board and a Reserve Bank, the lender agreed to steps that included paying \$3.8 million to minority customers identified by the Department of Justice as having been overcharged on a discriminatory basis.

The ECOA also requires the referral of certain types of violations of the act, other than "pattern and practice," to HUD. The three cases of that type referred during 1996 involved alleged discrimination on the basis of race, national origin, and gender. At year-end,

all three were pending final resolution by HUD.

The Board continued the refinement of its specialized fair lending school during 1996. The two-week school comprises an extensive range of both conceptual and practical topics. Subjects include a historical perspective on the development of fair lending law; current legal theories of lender liability; and an introduction to fair lending examination techniques, including off-site preparation, detection techniques for various loan products, and methodologies for analyzing examination findings. Class work includes lectures, analysis of case histories, and role-playing. During 1996, eighty students attended the fair lending school and received more than seventy hours of training. An extensive revision of this school, begun late in 1996 on the basis of proposals from instructors and students to make it more interactive, is due for completion in 1997.

In evaluating compliance with fair lending laws, bank examiners assess decisions in relation to the underwriting standards of the lending institution. They sample approved and denied applications and check whether the institution, in applying its lending criteria, has implemented standards consistently and fairly and whether any differential treatment warrants further investigation. Examiners also review underwriting standards used by the institution in order to identify standards that may raise concerns in the context of fair lending enforcement.

To facilitate fair lending reviews, examiners often use data collected and reported under the Home Mortgage Disclosure Act (HMDA). The HMDA data do not include the wide range of financial and property-related factors that lenders consider in evaluating loan applications, and therefore these data alone cannot determine the presence or

absence of discrimination. Nonetheless, access to loan application files and related information enables examiners to augment the data in making determinations regarding unlawful discrimination.

In addition, since 1994 the Federal Reserve has used a two-stage statistical analysis system to aid in the fair-lending examination of large-volume mortgage lenders. In the first stage of the analysis, examiners use HMDA data recorded by the institution on its loan-application register to help determine whether race appears to be a significant factor in a bank's lending decisions. The Board substantially enhanced the first-stage system during 1996. Instead of basing the initial assessment of racial disparities on a random sample of white and minority applications, the first-stage program now uses a sample of white and minority applicants that have been matched on the basis of characteristics (such as income, loan amount, and property location) that are available from the HMDA data.

When the first-stage analysis indicates a statistically significant difference in the results for white applicants compared with those for minority applicants, examiners will generally proceed to the second stage of the analysis. In the second stage, examiners draw extensive additional information from the bank's loan application files. The augmented information allows for a more sophisticated matched-pair statistical analysis that identifies specific loan files for examiners to review and discuss with management during their on-site fair lending evaluation.

### **HMDA Data and Lending Patterns**

The Home Mortgage Disclosure Act requires covered mortgage lenders in metropolitan areas to disclose data

regarding mortgages for home purchase, home improvement, and home refinancing. In 1996, depository institutions and mortgage companies generally were covered if they were located in metropolitan areas and had assets of more than \$10 million. Independent mortgage companies were covered, regardless of their asset size, if they originated 100 or more home purchase loans in the preceding calendar year. In 1996, 9,539 lenders, consisting of 868 independent mortgage companies and 8,671 other mortgage lenders, reported data for calendar year 1995.<sup>1</sup>

Under HMDA, covered lenders submit geographic information about the property related to a loan transaction, the disposition of loan applications, and, in most cases, the race or national origin, income, and sex of applicants and borrowers. The Board processes the data and prepares disclosure statements on behalf of HUD and member agencies of the Federal Financial Institutions Examination Council (FFIEC).<sup>2</sup>

In 1996 the Board prepared roughly 36,600 disclosure statements. The 1995 data contained 11.2 million reported loans and applications, an 8 percent decrease from 1994 that is largely attributable to a decline in refinancing activity.<sup>3</sup> In July, individual institutions made

these disclosure statements public, and in August, aggregate reports that contain data for all lenders in a given metropolitan statistical area (MSA) became available in printed form at a central depository in each of the nation's 330 MSAs. The FFIEC also makes the information available on microfiche, magnetic tape (reel and cartridge), PC diskette, and CD-ROM.

Lending institutions tend to specialize in different types of home loans. In 1995, depository institutions continued to be the predominant source of home improvement and multifamily loans. Mortgage companies accounted for about 52 percent of the conventional home purchase loans reported and about 80 percent of the government-backed home purchase loans.

Mortgage originators and institutions in the secondary market for mortgages, such as Fannie Mae (the Federal National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation) offer a variety of home loan programs to benefit lower-income and minority households and neighborhoods. These programs may account for a continued increase in loans to these homebuyers. From 1993 to 1995 the number of conventional home purchase loans extended to lower-income borrowers increased 21 percent, compared with a 10 percent increase for higher-income homebuyers over the same period.

Lending to minority homebuyers has also increased markedly. From 1993 to 1995 the number of loans to black applicants increased 70 percent, to Hispanic applicants 48 percent, and to Asian applicants 24 percent. The increase for white applicants was 12 percent over the same period.

The 1995 data continue to show rates of credit denial that are higher for black and Hispanic loan applicants than for

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1. In September 1996 the Congress amended HMDA to raise the asset threshold for depository institutions according to changes in the consumer price index for urban wage and clerical workers since 1975. Beginning in January 1997, a depository institution will be subject to HMDA if its assets were greater than \$28 million at year-end 1996. The asset-size measure that determines the coverage for independent mortgage companies is unchanged.

2. The member agencies are the Board, the FDIC, the National Credit Union Administration, the OCC, and the OTS.

3. A summary of the 1995 HMDA data appears in a series of special tables included in the *Federal Reserve Bulletin*, vol. 8 (September 1996), pp. A68-A75.

Asian and white applicants even within the same income brackets. In 1995 the denial rates for conventional home purchase loans overall were 41 percent for black applicants, 30 percent for Hispanic applicants, 13 percent for Asian applicants, and 21 percent for white applicants. These rates were all somewhat higher than in 1994. For neighborhoods, the data also show that the rate of loan denial generally increased with an increase in the proportion of minority residents.

The data collected under HMDA do not include the wide range of financial and property-related factors that lenders consider in evaluating loan applicants. Consequently, the data alone do not provide an adequate basis for determining whether a lender is discriminating unlawfully. But because the data can be supplemented by other information available to the agencies, they are an important tool for enforcement of fair lending laws.

The important uses of the HMDA data make their accuracy critically important. The FFIEC's processing software is programmed to identify errors in the data submitted by lenders for correction before disclosure statements and reports for specific MSAs are prepared. Since lenders first began submitting their HMDA data in case-by-case (single-record) form rather than aggregated by census tract, the quality has improved considerably. The proportion of 1995 loan records containing detected errors was less than 0.5 percent, down from about 4.4 percent in 1991 (the first year in which data were reported on a case-by-case basis).

### Other Uses of HMDA Data

Since 1990 the HMDA data reported by lenders have included information about the race, sex, and income of

borrowers and loan applicants. For loans sold, lenders also identify purchasers by type of entity. These expanded data provide opportunities to assess the relative performance of mortgage lending institutions in serving the credit needs of lower-income and minority homebuyers.<sup>4</sup>

In its oversight of housing activities by government-sponsored entities, HUD uses the expanded HMDA data to help assess the efforts of Fannie Mae and Freddie Mac in attaining goals for supporting mortgages for low- and moderate-income families and for properties in targeted communities. HUD also makes extensive use of the HMDA data as one component of its fair lending reviews. The data assist in the handling of loan applicants' and borrowers' allegations of lending discrimination filed with HUD, the Department of Justice, or state and local agencies; the data also assist in the agencies' targeting of lenders for investigation.

### Private Mortgage Insurance

The FFIEC also compiles HMDA-like data pertaining to applications for private mortgage insurance (PMI) on behalf of the nation's eight active PMI companies. PMI typically is required by lenders when they extend conventional mortgages with small down payments.

Working through their national trade association, the Mortgage Insurance Companies of America, the PMI companies voluntarily submit their data to the FFIEC, which prepares company-

4. See, for example, the discussion of which institutions bear the credit risk of mortgages extended to lower-income and minority homebuyers in Glenn B. Canner, Wayne Passmore, and Brian J. Surette, "Distribution of Credit Risk Among Providers of Mortgages to Lower-Income and Minority Homebuyers," *Federal Reserve Bulletin*, vol. 82 (December 1996), pp. 1077-1102.

specific disclosure statements for each of the firms and aggregate reports for each metropolitan area. These reports are available for public review at the central depositories where HMDA data are available. Like the HMDA data, this information is also available from the FFIEC in other formats, including data tape, CD-ROM, and PC diskette.<sup>5</sup>

### **Community Development**

The Federal Reserve System's Community Affairs programs identify community development and reinvestment needs along with fair lending issues; and they develop educational, informational, and technical assistance programs to facilitate constructive responses by banks and their communities. During 1996 the System's Community Affairs programs continued to expand and enhance products and services to help banks and community representatives assess needs and implement fair lending, community development, and reinvestment programs.

Six Reserve Banks engaged in major efforts to help identify and address barriers to equal access to credit for homebuyers. The Boston, New York, Cleveland, Atlanta, St. Louis, and Chicago Banks each identified key participants in the homebuying process in their Districts and brought them together with community representatives to discuss problems affecting minority and lower-income homebuyers and forge collaborative solutions. These community-targeted programs are based on an effort pioneered by the Cleveland Reserve Bank in its home city. The program generally includes the formation of task groups that focus on key aspects of the

lending process and then develop findings and action plans.

During 1996 the Community Affairs programs sponsored or cosponsored more than 200 conferences, seminars and informational meetings on community development, reinvestment, and fair lending topics. The programs were attended by about 10,800 bankers, examiners, and representatives of small businesses and community and consumer groups. In addition, staff members of the Community Affairs programs at the Board and the Reserve Banks made more than 260 presentations at conferences, seminars, and meetings sponsored by banking, governmental, business, and community organizations.

The Reserve Banks' Community Affairs programs helped design and conduct a wide variety of conferences and training programs for bankers and community representatives that focused on the revised regulations implementing the Community Reinvestment Act. They also participated in Federal Reserve and interagency training for examiners who conduct CRA assessments of financial institutions.

The Reserve Banks of Boston, Philadelphia, Richmond, Atlanta, Chicago, Dallas, Kansas City, Minneapolis, and San Francisco held a variety of conferences and workshops on aspects of community development finance.

Several Reserve Banks developed programs focused on the development of small and minority businesses. The Boston Reserve Bank sponsored a conference for Maine bankers, nonprofit lenders, and public officials regarding microenterprise lending and other resources available to help the financing of Maine's small and start-up businesses. In addition the Boston Bank worked with Maine bankers to help develop the new Maine Community Reinvestment Corporation, a statewide

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5. For an analysis of the 1995 private mortgage insurance data, see appendix A of Canner, Passmore, and Surette, "Distribution of Credit Risk."

multibank lending consortium for affordable housing; and the Dallas Reserve Bank sponsored several seminars for small-business owners. The San Francisco Reserve Bank held a conference to foster closer working relationships among bankers, small businesses, and organizations providing technical assistance to small firms.

A conference at the Kansas City Reserve Bank targeted public policy issues affecting rural capital markets, and the New York Reserve Bank convened a conference on delivering capital resources for economic development in non-urban areas. The San Francisco Reserve Bank sponsored a conference on electronic banking that focused on how technological changes affect the relationship between consumers and their financial institutions.

In response to a rising number of requests for assistance and information on community development investments by financial institutions, the Community Affairs programs developed or expanded a variety of publications and other informational resources. The Board significantly expanded its annual compendium entitled *Directory: Community Development Investments*, by adding discussions of investments by state member banks to those about investments made by bank holding companies. The directory now covers more than 150 existing community development corporations and investments. The Board's Community Affairs program also assisted other divisions at the Board in addressing community development policy issues.

Other informational products distributed by the System's Community Affairs programs covered a broad array of topics. The Dallas Reserve Bank published *Texas Colonias: A Thumbnail Sketch of the Conditions, Issues, Challenges and Opportunities*. The report, which received national recognition, de-

scribes conditions in, and possibilities for assistance to, low-income, unincorporated subdivisions that have sprung up along the Texas-Mexico border. To assist bankers and others, the Dallas Reserve Bank also developed and published *Banking on Partnerships: A Digest of Community-Based Organizations in Houston*, which profiles the structure and activities of community development organizations in the Houston area.

The Minneapolis Reserve Bank produced and distributed a new educational video, *Lending in Indian Country*, which focuses on the challenges and unique opportunities in financing business and real estate development on reservations. The Minneapolis Reserve Bank also played a leadership role in an effort to bring together tribal and business leaders to explore economic development initiatives for the economically distressed Pine Ridge Reservation, in South Dakota.

The Federal Reserve Bank of Kansas City developed and published *Doing the Undoable Deals: A Resource Guide to Financing Housing and Economic Development*. The guide describes a variety of financial and management assistance programs available to community development projects.

All twelve Federal Reserve Banks continued to expand and enhance their Community Affairs newsletters. These publications typically feature information on community development lending and investment programs and related CRA, HMDA, and fair lending policies and issues. During 1996, Reserve Bank Community Affairs newsletters reached more than 74,000 representatives of financial institutions, community organizations, local government agencies, and others interested in bank involvement in community development and reinvestment efforts.

During 1996 the Banks' Community Affairs staffs held more than 1,400 meetings with bankers, government officials, and business and community representatives to discuss community development, community reinvestment, and related programs being undertaken by bankers and their communities. The Richmond Reserve Bank issued community profiles highlighting community needs and development organizations and resources in the areas of Richmond; Columbia, South Carolina; and Hagerstown, Maryland. The Philadelphia Reserve Bank published a profile on Williamsport, Pennsylvania. And the St. Louis Reserve Bank issued metropolitan-area profiles for Owensboro, Kentucky; Fayetteville-Springdale-Rogers, Arkansas; and Springfield, Missouri.

To supplement its outreach activities, the Boston Reserve Bank formed a Community Development Advisory Council, composed of lenders and representatives of public and nonprofit agencies who are knowledgeable about housing and economic development issues. The council will meet three times each year with the Reserve Bank President and staff members of the Community Affairs program to discuss regional community development and reinvestment issues. The Atlanta Reserve Bank developed an extensive database of community contacts; and all of the federal banking regulators are considering adoption of its database structure.

Another significant part of Board and Reserve Bank Community Affairs activities is assisting the Federal Reserve's bank supervisory units regarding CRA and fair lending. The Board's Community Affairs program helped conduct consumer compliance and fair lending schools, participated in inter-agency efforts to adapt policies for the implementation of revised CRA rules,

and provided other briefings and educational training programs for examiners. The Community Affairs programs at the Atlanta, Richmond, and Kansas City Reserve Banks helped develop and implement an interagency training program on community development for examiners located in the Southeast.

In 1996 the capacity and efficiency of the computerized Community Lending Analysis System (CLAS) was increased in response to examiner feedback. The system gives examiners detailed economic and demographic information on a bank's community and helps increase consistency in the development of CRA assessments and ratings. In addition, the federal banking agencies coordinated with each other in reviewing examiner experience with CLAS and developed a consensus on which data elements and report formats were most useful to examiners.

### **Other Regulatory Matters**

In December, the Board solicited comment regarding issues that the Board will address in a study concerning the public availability and use of sensitive identifying information about consumers. The study is required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996, which sets a March 1997 deadline for reporting to the Congress. Other regulatory actions taken during the year, some of them also required by the 1996 act, are discussed below.

#### **Regulation B (Equal Credit Opportunity)**

In December the Board published proposed revisions to Regulation B to carry out amendments to the Equal Credit Opportunity Act. These amendments create a legal privilege for information

developed by creditors as a result of “self tests” that they voluntarily conduct to determine their level of compliance with the ECOA. (In January 1977 the Department of Housing and Urban Development published a substantially similar proposal to revise the regulations carrying out the Fair Housing Act.)

In December the Board withdrew a proposed amendment to Regulation B that would have eliminated a general prohibition on collecting data relating to an applicant’s sex, race, color, religion, or national origin. The proposed amendment would have allowed creditors to collect these data for any credit product. The Board determined that the issue of data collection is more appropriate for the Congress to consider.

### Regulation C (Home Mortgage Disclosure)

In December the Board published proposed revisions to Regulation C to carry out amendments to the Home Mortgage Disclosure Act. Those amendments require an increase in the exemption threshold for depository institutions, from \$10 million to \$28 million, based on the increase in the consumer price index for urban wage and clerical workers from 1975 to year-end 1996. Under the statutory amendments, the Board will make future changes to the asset threshold annually as appropriate. The amendments also modify the requirements applicable to disclosures for metropolitan areas in which an institution has branch offices.

### Regulation E (Electronic Fund Transfers)

In April the Board published revisions to Regulation E and the associated staff commentary following a review under the Board’s Regulatory Planning and

Review program. The final rule contains substantive amendments, including changes to the existing exemptions for securities or commodities transfers. Primarily, however, the revisions simplify the language and format of the regulation and commentary and delete obsolete provisions.

The review of Regulation E served to identify other issues that might warrant regulatory changes. In April the Board published proposed amendments to Regulation E to govern stored-value cards. The proposal also addresses general provisions of the regulation, providing longer error-resolution deadlines for new accounts and allowing electronic disclosures to consumers in place of printed notices.

### Regulation M (Consumer Leasing)

In September the Board published a revised Regulation M following a multi-year review under the Board’s Regulatory Planning and Review program. Regulation M requires lessors to give consumers uniform disclosures of cost and other lease elements before the lease becomes legally binding. In its review the Board sought to identify ways that it could simplify the regulation to fulfill the Congress’s intentions more effectively. The final rule modernized the regulation to address changes that have taken place in consumer leasing since 1976, the year the Congress passed the Consumer Leasing Act,

The final rule adds disclosures, primarily in connection with motor vehicle leasing. The Board determined that these revisions were especially necessary given that about one-third of all passenger cars now delivered to consumers are leased instead of purchased and financed. The disclosures concern charges a consumer might face for early

termination, for example, and how scheduled payments are derived. The Board also specified certain aspects of the format of the disclosures. The Board revised the advertising provisions to carry out a statutory amendment, allowing toll-free numbers to substitute for certain disclosures in radio and television advertisements. The Board also provided that any disclosure or advertisement of a lease rate must inform the consumer that the rate may not measure the overall costs of the lease financing. This limitation is meant to preclude inappropriate and erroneous comparisons of lease costs based on rate information offered to consumers by different lessors.

In December the Board published proposed revisions to Regulation M, primarily to implement amendments to the Consumer Leasing Act, which had been enacted in September. The proposed revisions streamline the advertising disclosures and make several technical amendments.

### Regulation Z (Truth in Lending)

In January the Board requested comment on whether, under the Truth in Lending Act (TILA), cost disclosures and other rules for open-end home-secured lines provide adequate consumer protection. In November the Board reported to the Congress, as required by the Riegle Community Development and Regulatory Improvement Act of 1994. The report describes the regulatory framework for open-end home equity lines of credit compared with that for closed-end credit and discusses information drawn from consumer surveys. The report presents the Board's analysis of issues and its findings that the current requirements provide adequate consumer protection.

The Board is required to adjust annually the dollar amount that triggers additional disclosure requirements under TILA for mortgage loans that bear fees above a certain amount. The Home Ownership and Equity Protection Act of 1994 imposes restrictions and special disclosure requirements when total points and fees payable by the consumer exceed the greater of \$400 or 8 percent of the total loan amount. Under the act, the Board must adjust the dollar amount each year according to the percentage change in the consumer price index. In January the Board adjusted the dollar amount to \$412 for 1996; in December it adjusted the dollar amount to \$424 for 1997.

In April the Board issued a report to the Congress, required by the Truth in Lending Act Amendments of 1995, that discussed the feasibility of treating as finance charges all costs required by the creditor or paid by the consumer as an incident of credit; the report also addressed abusive refinancing practices. The Board determined that, although changing the definition of finance charge may be desirable, changes affecting disclosure of the finance charge and the annual percentage rate would be significant for both creditors and consumers. The Board concluded that changes, if any, should be preceded by further deliberation and participation from the public. The Board will consider regulatory revisions consistent with the report in an upcoming review of Regulation Z.

In May the Board published proposed revisions to Regulation Z to carry out the statutory amendments enacted in 1995 that establish new creditor-liability rules for closed-end loans secured by real property or dwellings. The TILA amendments created new tolerances for accuracy in disclosing the amount of the finance charge. The amendments also clarify how lenders must disclose cer-

tain fees connected with mortgage loans. In addition the Board proposed a new rule regarding the treatment of fees charged in connection with debt cancellation agreements. In September the Board published a final rule adopting the revisions.

In December the Board and HUD issued a joint advance notice of proposed rulemaking to revise disclosures that consumers receive under the Real Estate Settlement Procedures Act (RESPA) and TILA. Amendments to RESPA and TILA require the agencies to simplify and improve the disclosures where possible and to provide a single format for compliance with both RESPA and TILA. The notice solicited public comment on the specific regulatory and legislative changes that might achieve these goals.

### Interpretations

In March the Board revised the official staff commentary to Regulation Z (Truth in Lending). The update gives guidance on issues relating to reverse mortgages and to home-secured loans bearing rates above a certain percentage or fees above a certain amount. The revisions also address issues of general interest, such as a card issuer's responsibilities when a cardholder asserts a claim or defense relating to a dispute with a merchant.

In November the Board published proposed changes to the staff commentary to Regulation Z. The proposed revisions provide guidance on the treatment of some fees paid for mortgage loans, of tolerances for accuracy in disclosing the finance charge and other costs, and of debt cancellation agreements.

In May the Board withdrew a proposed amendment to the official staff commentary to Regulation DD (Truth in Savings) because of its narrow scope and regulatory burden. The proposal

addressed technical matters such as the effect of a leap year on the calculation of interest, on the annual percentage yield, and on the annual percentage yield earned.

In September the Board revised the official staff commentary to Regulation B (Equal Credit Opportunity). The update gives guidance on issues such as credit scoring and the regulation's spousal signature rules.

### **Economic Effects of the Electronic Fund Transfer Act**

In keeping with statutory requirements, the Board monitors the effect of the Electronic Fund Transfer Act on the compliance costs and consumer benefits related to electronic fund transfer (EFT) services.

The revisions to Regulation E made in 1996 and discussed above reduce somewhat the ongoing burden of compliance with the regulation without materially affecting consumer benefits. The revisions to Regulation E were limited because the original regulation already followed closely the detailed requirements of the law.

In 1996 the Congress amended the Electronic Fund Transfer Act to exempt needs-tested programs that are established or administered by state or local governments for the electronic transfer of benefits. (The Board expected to propose an implementing amendment to Regulation E in January 1997.) The exemption eliminates uncertainty about potential fraud arising from the EFTA's liability rules and will reduce the cost to state and local governments of providing benefits electronically. Under the exemption, benefit recipients may have somewhat diminished protections, especially for unauthorized use. Electronic delivery will, however, likely provide benefit recipients greater overall secu-

rity than the paper-based systems that are now in use.

Some economic effects of the Electronic Fund Transfer Act, both consumer benefits and compliance burden, can be traced to continued growth in the use of EFT services. During the 1990s the proportion of U.S. households using EFT services has increased at an annual rate of about 2 percent. Surveys indicate that about 85 percent of households now have one or more EFT features on their deposit accounts.

Automated teller machines are the most widely used EFT service. Nearly two-thirds of all households currently have ATM cards, and most of the nation's depository institutions offer consumers access to ATMs. Over time, almost all ATM terminals have become connected to one or more shared networks, which enhances their accessibility to consumers. The monthly average number of ATM transactions increased about 10 percent, from 807.4 million in 1995 to 890.3 million in 1996. During the same period, the number of installed ATMs rose 13 percent, to 139,134.

Direct deposit is another widely used EFT service. More than one-half of all U.S. households receive funds in their accounts via direct deposit by the payer. Direct deposit is particularly widespread in the public sector, covering more than one-half of social security payments and two-thirds of federal salary and retirement payments. Although less common in the private sector, direct deposit has grown substantially in recent years. The proportion of households receiving either public-sector or private-sector direct deposits has grown about 5 percent per year during the 1990s.

Nearly one-third of households now have debit cards, which can be used at the point of sale to debit a consumers' transaction account. Point-of-sale (POS) systems still account for only a

small share of electronic transactions, but rapid growth continued in 1996: the number of POS transactions rose nearly one-half, to about 96 million per month; and the number of POS terminals rose about two-thirds, to around 875,000.

The incremental costs associated with the EFT act are difficult to quantify because no one knows how industry practices would have evolved in the absence of statutory requirements. The benefits of the law are also difficult to measure because they cannot be isolated from consumer protections that would have been provided in the absence of regulation. The available evidence provides no indication of serious consumer problems with electronic transactions at this time.

The Board's database of consumer complaints and inquiries is one source of information on potential problems. In 1996, eighty of the complaints that were received related to electronic transactions. The Board forwarded forty-five complaints that did not involve state member banks to other agencies for resolution. Of the remaining thirty-five complaints, three involved a possible violation of the act or regulation. Examination data show that in 1996 about 94 percent of depository institutions examined by federal agencies were in full compliance with Regulation E. Violations primarily involved failure to provide all required disclosures to consumers.

## **Compliance Examinations**

Since 1977 the Federal Reserve System has maintained a specialized program for examining the compliance of state member banks and of certain foreign banking organizations with federal laws governing consumer protections in financial services. During the 1996

reporting period (from July 1, 1995, to June 30, 1996), the Federal Reserve examined 607 state member banks and 306 foreign banking organizations for such compliance.<sup>6</sup>

The Oversight Section of the Board's Division of Consumer and Community Affairs coordinates compliance examinations, which are conducted by the consumer affairs units of the twelve Federal Reserve Banks. The Oversight Section reviews a sample of the examinations for effectiveness, adherence to System policy, uniformity of approach, and the like.

New examiners from the Federal Reserve Banks attend the System's three-week basic consumer compliance school; examiners with eighteen to twenty-four months of field experience attend a week-long advanced compliance school, a two-week fair lending school, and a class in CRA examination techniques.<sup>7</sup>

In the 1996 reporting period, the Federal Reserve System conducted three basic consumer compliance schools for a total of seventy-five students; five advanced consumer compliance schools for seventy-three students; and two fair lending schools for sixty-two students.

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6. The Federal Reserve examines state-chartered agencies and state-chartered uninsured branches of foreign banks, which are commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25(a) of the Federal Reserve Act (Edge Act corporations and agreement corporations). Typically, in comparison with state member banks, these institutions conduct relatively few activities that are covered by consumer protection laws.

7. In 1996, Federal Reserve examiners attended interagency training for the revised CRA in place of the advanced CRA class. In addition, CRA instruction was included in the advanced consumer compliance school while the CRA school was being revised to reflect the requirements of the CRA regulations published by the agencies in May 1995.

The Reserve Banks supplement examiner training through departmental meetings and special training sessions. In addition the Board's resident examiner program gives the Reserve Bank examiners added perspective through several weeks' work at the Board, during which they can observe such matters as how policies are developed and how the Board coordinates its activities with those of other agencies that supervise financial institutions.

The FFIEC is the interagency coordinating body charged with developing uniform examination principles, standards, and report forms. In 1996 the member agencies of the FFIEC collaborated to revise examination procedures to reflect changes in consumer laws and regulations. They adopted changes to examination procedures covering amendments to the Flood Disaster Protection Act and to the Home Mortgage Disclosure Act.

### Agency Reports on Compliance with Consumer Regulations

Data from the Board, other member agencies of the FFIEC, and other federal supervisory agencies cover the compliance of institutions with the regulations that implement the Equal Credit Opportunity Act, the Electronic Fund Transfer Act, the Consumer Leasing Act, the Truth in Lending Act, the Community Reinvestment Act, and the Expedited Funds Availability Act; and compliance with the prohibition in Regulation AA against unfair and deceptive practices.<sup>8</sup> The degree of compliance with these laws and regulations varied widely in

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8. The federal agencies that supervise financial institutions do not use the same method to compile compliance data. Consequently, the data in this report, which are presented in terms of percentages of all financial institutions, represent general conclusions.

1996 but, overall, showed improvement over 1995. The following section summarizes compliance data for the period from July 1, 1995, to June 30, 1996.

### Equal Credit Opportunity Act (Regulation B)

The five financial regulatory agencies reported a level of full compliance with Regulation B by institutions examined in 1996, 78 percent, that was significantly higher than the 1995 level of 62 percent. The agencies reported that 77 percent of the institutions examined that were not in full compliance with the regulation had between one and five violations (the lowest frequency category), compared with 74 percent in 1995. The most frequent violations involved the failure to take the following actions:

- Provide a written notice of adverse action that contains a statement of action taken, the name and address of the creditor, an ECOA notice, and the name and address of the federal agency that enforces compliance
- Collect information, for monitoring purposes, about the race or national origin, sex, marital status, and age of credit applicants (on applications for the purchase or refinancing of a principal residence)
- Notify the applicant of the action taken within the periods specified in the regulation
- Give a statement of reasons for adverse action that is specific and indicates the principal reasons for the credit denial or other adverse action
- Take a written application for credit for the purchase or refinancing of a principal residence.

The Board issued one cease-and-desist order addressing violations of Regulation B. The OTS issued four for-

mal enforcement actions that addressed violations of Regulation B as well as of other consumer compliance regulations. The FDIC issued five formal enforcement actions involving consumer compliance regulations, without distinguishing which of those actions involved Regulation B.

The other agencies that enforce the ECOA—the Farm Credit Administration (FCA); the Department of Transportation; the Small Business Administration; and the Grain Inspection, Packers, and Stockyards Administration of the Department of Agriculture—reported substantial compliance among the entities they supervise. The FCA's examination and enforcement activities revealed violations of the ECOA that resulted in one formal action. The FCA reported that the most frequent violations it found involved the failure to collect monitoring information and the timeliness or content of creditors' adverse action notices.

The Federal Trade Commission (FTC) concluded an investigation of a major retailer that resulted in the filing of a consent decree against the company for violating the notification provisions of the ECOA. In addition, the FTC reported a continuation of its work with other government agencies and with creditor and consumer organizations to increase awareness of, and compliance with, the ECOA.

### Electronic Fund Transfer Act (Regulation E)

The five financial regulatory agencies reported that approximately 94 percent of examined institutions were in compliance with Regulation E, a slight increase over the level of compliance reported for 1995. Financial institutions most frequently failed to comply with the following provisions:

- Provide a notice of the procedures for resolving alleged errors at least once each calendar year
- Investigate alleged errors in a prompt manner, determine whether an error actually occurred, and transmit the results of the investigation and determination to the consumer within ten business days
- Provide initial disclosures at the time a consumer contracts for an EFT service or before the first transfer is made
- Provide customers with a statement of all required information at least quarterly, or monthly if EFT activity occurred.

The OTS issued two formal enforcement actions addressing violations of Regulation E, and the FTC accepted for public comment a consent agreement against a telemarketing company for failing to obtain written authorization from consumers for preauthorized transfers. If accepted, the FTC's proposed order would be incorporated into settlement of a civil penalty action, currently pending in federal district court, against the telemarketer and its dealers. The FDIC reported five formal enforcement actions to deal with violations of Regulation E and other consumer compliance regulations without specifying how many of the five involved electronic fund transfers.

### Consumer Leasing Act (Regulation M)

The FFIEC agencies reported substantial compliance with Regulation M for the 1996 reporting period. As in the 1995 reporting period, more than 99 percent of the examined institutions were found to be in full compliance with the regulation. The violations noted by the agencies involved the failure to adhere to specific disclosure requirements.

The Farm Credit Administration reported that the institutions it supervises were in substantial compliance with the regulation. The agency found no violations through its examination and enforcement activities.

The FTC accepted for public comment five consent agreements with major automobile manufacturers addressing violations of both Regulation M and Regulation Z (Truth in Lending). The proposed orders would settle charges that all five companies violated Regulation M in lease promotions that featured low monthly payments or low down payments in large, bold print while disclosing additional costs and sometimes contradictory information in fine print that was difficult or impossible to read. The complaints in these cases also charged the automobile manufacturers with violations for failing to clearly and conspicuously disclose various lease costs and terms as required.

The FTC has continued its consumer and business education efforts. To this end, the FTC released two brochures addressing leasing issues. The first highlighted points to consider when deciding whether to lease or purchase a vehicle. The second provided information to consumers regarding the lease or purchase of residential telephones.

### Truth in Lending Act (Regulation Z)

The FFIEC agencies reported that nearly 70 percent of examined institutions were in full compliance with Regulation Z, a significant improvement over the 50 percent reported for 1995. The Board and the OCC showed increases in compliance, and the NCUA reported a decrease, while the FDIC and the OTS reported unchanged levels of compliance. Agencies indicated that, of the examined institutions not in compliance,

63 percent were in the lowest frequency category (having between one and five violations), compared with 58 percent in 1995.

The violations of Regulation Z most often observed were the failure to accurately disclose the finance charge or to disclose the payment schedule; to accurately disclose the annual percentage rate on closed-end credit; to accurately disclose the amount financed; and to provide a disclosure that reflects the terms of the legal obligation between the parties.

The OTS issued five formal enforcement actions that addressed violations of Regulation Z, and the FDIC reported five formal enforcement actions involving consumer compliance regulations without distinguishing which of those actions involved Regulation Z.

Under the Interagency Enforcement Policy on Regulation Z, 394 institutions supervised by the Board, the FDIC, the OCC, or the OTS were required to refund \$2.8 million to consumers in 1996 for improper disclosures.

The Department of Transportation issued a cease and desist consent order against a travel agency and a charter operator. The complaint in this case alleged that the two organizations violated Regulation Z by routinely failing to transmit requests for refunds to credit card issuers within seven days of receipt of fully documented credit refund requests.

The FTC accepted for public comment two consent agreements with major automobile manufacturers addressing violations of Regulation Z. The proposed orders would settle charges that the companies violated Regulation Z in credit promotions by making inadequate and misleading disclosures comparable to those in promotions discussed above, in the section on consumer leasing. The FTC also accepted

for public comment a consent agreement with a mortgage banking company. The proposed order in this case would settle charges that the company failed to accurately calculate and disclose several items in its mortgage agreements as required by Regulation Z. In addition, the FTC dismissed a complaint against a department store alleging that the store had imposed "unreasonable burdens" on cardholders who claimed their cards were used without authorization.

The FTC released a brochure addressing the protections of TILA and Regulation Z for "high rate, high fee" loans.

### Community Reinvestment Act (Regulation BB)

The Board assesses the CRA performance of state member banks during regular compliance examinations and takes the CRA record into account along with other factors when acting on applications from state member banks and bank holding companies. The Federal Reserve System maintains a three-faceted program for enforcing and fostering better bank performance under the CRA:

- Examining institutions to assess compliance
- Disseminating information on community development techniques to bankers and the public through community affairs offices at the Reserve Banks
- Performing CRA analyses in connection with applications from banks and bank holding companies.

Under the provisions of the CRA, Federal Reserve examiners review the performance of state member banks in helping to meet the credit needs of their communities. When appropriate, examiners suggest ways to improve CRA per-

formance. During the 1996 reporting period, the Federal Reserve conducted 596 CRA examinations: 2 banks were rated as being in “substantial noncompliance” with the CRA, 4 were rated as “needs to improve” in meeting community credit needs, 417 were rated “satisfactory,” and 173 were rated “outstanding.”<sup>9</sup>

### Expedited Funds Availability Act (Regulation CC)

The FFIEC agencies reported that 87 percent of the institutions they examined were in full compliance with Regulation CC, an increase over the level of compliance in the 1995 reporting period. Of the institutions not in full compliance, 83 percent were in the lowest frequency category (between one and five violations). Among all institutions examined, the following five rules were the provisions of Regulation CC most often violated:

- Follow special procedures for large deposits
- Adequately train employees and provide procedures to ensure compliance with the regulation
- Provide immediate availability on \$100 of deposits not subject to next-day availability
- Make funds from certain checks, including local or nonlocal checks, available for withdrawal within the times prescribed by the regulation
- Provide a disclosure of the institution’s specific availability policy.

The OTS issued two formal enforcement actions regarding violations of Regulation CC, and the FDIC reported

five formal enforcement actions involving consumer compliance regulations without identifying the regulations involved.

### Unfair and Deceptive Acts or Practices (Regulation AA)

The three financial regulatory agencies with responsibility for enforcing Regulation AA’s Credit Practices Rule reported that more than 99 percent of examined banks were in full compliance with the regulation. The most frequent violation involved the failure to provide a clear and conspicuous disclosure on cosigner liability.

### Applications

The Federal Reserve System acted on forty-nine bank and bank holding company cases that involved CRA protests or adverse CRA ratings. The System reviewed another thirteen cases that involved fair lending and other issues related to compliance with consumer regulations.<sup>10</sup> Among the forty-nine cases that raised CRA concerns in 1996, seven involved adverse CRA ratings, forty-one were protested on CRA grounds, and one involved both adverse CRA rating issues and protests.

Several applications for major bank acquisitions were filed and all were protested on CRA grounds. The Board approved the applications, finding in each case that the convenience and needs factors involved were consistent with approval.

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9. Foreign banking organizations and Edge Act and agreement corporations accounted for 306 of the institutions examined for compliance with consumer laws; they are not subject to the CRA.

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10. In addition, seven cases involving CRA issues and three involving other compliance issues were withdrawn during 1996. The System also reviewed comments submitted in connection with three other applications (not reflected in the above statistics), which were deemed to be more in the nature of consumer complaints than protests.

In January the Board approved the application of Chemical Banking Corporation (New York) to acquire The Chase Manhattan Corporation (New York). As a result of the acquisition, The Chase Manhattan Corporation became the largest banking organization in the nation. The Federal Reserve had held public meetings in New York City on the application in conjunction with the New York State Banking Department in November 1995.

In January the Federal Reserve held public meetings in Los Angeles and San Francisco on the competing proposals by Wells Fargo & Company (San Francisco) and First Bank System (Minneapolis) to acquire First Interstate Bancorp (Los Angeles). Among the issues raised by the 311 parties that commented in connection with these meetings were branch closures in low- to moderate-income neighborhoods, the availability of banking services in California, and potential job losses.

First Bank System ultimately withdrew its application after the Securities and Exchange Commission raised issues about the bank's planned stock repurchase program, and in March the Board approved Wells Fargo's application. The Board indicated in its approval order that it would monitor the implementation of Wells Fargo's branch closing policy as well as the effect of its branching strategy on the availability of banking services in the communities served by the bank. As a result of the acquisition, Wells Fargo became the seventh largest banking organization in the nation and remained the second largest depository institution in California.

In December the Board approved the application of NationsBank Corporation (Charlotte, N.C.) to acquire Boatmen's Bancshares, Inc. (St. Louis), an acquisi-

tion that made NationsBank the fourth largest banking organization in the nation. A number of individuals and groups had protested the application, alleging violations of fair lending laws and weaknesses in NationsBank's CRA performance. The Board's approval order directed NationsBank to give the Federal Reserve Bank of Richmond a copy of any notices for branch closures effected in connection with the acquisition; the order also requires NationsBank to notify the Reserve Bank of any changes in its preliminary plan for closing branches.

## **Consumer Complaints**

The Federal Reserve investigates complaints against state member banks and forwards to the appropriate enforcement agencies complaints that involve other creditors and businesses (see accompanying table). The Federal Reserve also monitors and analyzes complaints about unregulated practices.

In 1996 the Federal Reserve received 2,955 consumer complaints: 2,378 by mail, 568 by telephone, and 9 in person.

### **Complaints about State Member Banks**

In 1996 the Federal Reserve investigated 1,232 complaints against state member banks (see accompanying table). About 59 percent involved loan functions: 5 percent alleged discrimination on a prohibited basis, and 54 percent concerned credit denial on non-prohibited bases (such as length of residency) and other unregulated lending practices (such as release or use of credit information). Another 27 percent of the 1,232 complaints involved disputes about interest on deposits and general deposit account practices. The remaining 14 percent concerned dis-

putes about electronic fund transfers, trust services, and miscellaneous bank practices.

The System also received 2,609 inquiries about consumer credit and banking policies and practices. In responding to these inquiries, the Board and Federal Reserve Banks gave specific explanations of laws, regulations, and banking practices and provided relevant printed materials on consumer issues.

### Unregulated Practices

Under section 18(f) of the Federal Trade Commission Act, the Board monitors complaints about banking practices that are not subject to existing regulations and focuses on those complaints that may be unfair or deceptive. Three categories accounted for 13 percent of the 2,002 complaints about unregulated practices received in 1996 involving both state member banks and other institutions: problems involving interest rates and terms of credit cards (95 complaints), other problems involving credit card accounts (94), and miscellaneous unregulated practices (80). Each of these

categories accounted for a small portion (5 percent or less) of all consumer complaints received by the System.

Many of the complaints about credit card interest rates and terms raised concerns about interest rate increases; allegations that banks charged an interest rate higher than had been agreed on transferred account balances; and concerns about the interest rates charged on cash advances. Complaints about credit card accounts involved a variety of customer service problems, including financial institutions' failure to close accounts as requested; failure to provide requested account information; and imposition of an annual fee after an account is closed. The miscellaneous category covered a wide range of issues including check cashing, release of liens, and customer service problems.

### Complaints Referred to HUD

The Federal Reserve continued to refer to HUD complaints that allege violations of the Fair Housing Act, as required by a memorandum of understanding between HUD and the federal

### Consumer Complaints to the Federal Reserve System Regarding State Member Banks and Other Institutions, by Subject, 1996

Subject	State member banks	Other institutions <sup>1</sup>	Total
Regulation B (Equal Credit Opportunity)	63	42	105
Regulation E (Electronic Fund Transfers)	35	45	80
Regulation Q (Interest on Deposits)	2	0	2
Regulation Z (Truth in Lending)	144	351	495
Regulation BB (Community Reinvestment)	3	3	6
Regulation CC (Expedited Funds Availability)	18	41	59
Regulation DD (Truth in Savings)	26	31	57
Fair Credit Reporting Act	30	70	100
Fair Debt Collection Practices Act	9	11	20
Fair Housing Act	1	0	1
Real Estate Settlement Procedures Act	1	19	20
Flood insurance	1	2	3
Holder in due course	1	4	5
Unregulated practices	898	1,104	2,002
<b>Total</b>	<b>1,232</b>	<b>1,723</b>	<b>2,955</b>

1. Complaints against these institutions were referred to the appropriate enforcement agencies.

bank regulatory agencies. This memorandum establishes a set of procedures for coordination and cooperation in the investigation of lending discrimination complaints falling under the scope of the Fair Housing Act.

In 1996 the Federal Reserve referred twelve complaints about state member banks to HUD. Investigations completed by the Federal Reserve for seven of the twelve 1996 complaints (and for two that had been pending from 1995) revealed no evidence of unlawful discrimination; five of the twelve complaints received in 1996 were pending at year-end.

### Complaint Program Initiatives

To better understand the type and scope of complaint activity at the federal level, the Board has undertaken an exchange of complaint data among the federal financial regulatory agencies. In 1995

the Board joined with the FDIC in analyzing the agencies' respective systems for categorizing complaints and researched ways to facilitate data exchange and analysis. In mid-1996 the Board initiated similar efforts with the OCC.

In recent years the Federal Reserve has received an increasing number of consumer complaints about credit card mail solicitations that consumers allege are misleading because they do not clearly set out the interest rates being charged and the credit limits offered. The Board has undertaken a study of the complaints received by the System as well as by the other federal financial regulatory agencies, state attorneys general, and state banking departments. To complement the data gathering, the Board included questions for two successive months on the Survey of Consumer Attitudes conducted by the University of Michigan's Survey Research Center. These survey data will help

Consumer Complaints Received by the Federal Reserve System, by Type and Function, 1996

Complaint	Complaints against state member banks					
	Total		Not investigated		Investigated	
	Number	Percent	Unable to obtain sufficient information	Explanation of law provided to consumer	Bank legally correct	
					No reimbursement or other accommodation	Goodwill reimbursement or other accommodation
<b>Loans</b>						
Discrimination alleged						
Real estate loans .....	12	1	0	0	5	0
Credit cards .....	25	2	1	0	12	6
Other loans .....	32	2	0	3	17	0
Discrimination not alleged						
Real estate loans .....	82	7	6	7	26	14
Credit cards .....	396	32	8	34	117	115
Other loans .....	181	15	4	18	82	25
Deposits .....	337	27	8	33	155	33
Electronic fund transfers .....	35	3	1	4	12	5
Trust services .....	12	1	1	1	5	2
Other .....	120	10	4	16	39	10
<b>Total .....</b>	<b>1,232</b>	<b>100</b>	<b>33</b>	<b>116</b>	<b>470</b>	<b>210</b>

define consumers' understanding of the credit terms used in mail solicitations and identify problems they have experienced. The Board expected to complete analysis of this issue in 1997.

In 1996 the Consumer Complaints Section implemented a comprehensive system to replace and consolidate the complaint program's current analysis tools. Along with other management tools, the Complaint Analysis Evaluation System and Reports (CAESAR) provides the capability to analyze the types of discrimination complaints received by the Federal Reserve, automatically generate response letters to the individual complaints, and analyze complaint data to determine patterns and trends.

In June the Board hosted the third annual conference for consumer complaint officers, managers, and other staff. The conference is an important forum for obtaining Reserve Bank input into

the formation of policies and procedures that affect the program. In 1996 it focused on the investigation and analysis of complaints alleging unlawful discrimination (particularly those that may involve appraisals), credit scoring, and other fair lending issues; the effect of the Right to Financial Privacy Act and Trade Secrets Act on complaint investigations; and the System's jurisdiction in investigating complaints about nonbank subsidiaries of holding companies.

In September the Consumer Complaints section began quarterly conference calls with the complaint program management and staff at the Reserve Banks. These calls provide an opportunity to discuss policies and procedures and specific issues that have arisen during the course of complaint investigations.

The Consumer Complaints Section and the Consumer Policies program began a series of meetings with the

Consumer Complaints Received—Continued

Complaints against state member banks						Referred to other agencies	Total complaints
Investigated					Pending, December 31		
Customer error	Bank error	Factual or contractual dispute—resolvable only by courts	Possible bank violation—bank took corrective action	Matter in litigation			
0	0	2	0	0	5	21	33
0	3	0	0	0	3	12	37
0	2	0	0	0	10	18	50
0	17	4	0	2	6	286	368
8	71	18	3	1	21	508	904
4	25	4	1	4	14	222	403
9	40	23	3	2	31	388	725
0	5	1	3	0	4	45	80
0	0	1	0	0	2	7	19
5	15	5	1	3	22	216	336
<b>26</b>	<b>178</b>	<b>58</b>	<b>11</b>	<b>12</b>	<b>118</b>	<b>1,723</b>	<b>2,955</b>

offices of selected state attorneys general and with state and local county consumer protection agencies to share information about complaint procedures and consumer education efforts. The goal of this effort is to establish contact for sharing data and information at the state and local levels and to expand the Board's ability to refer consumers to the proper authorities when they have issues that do not fall under the Federal Reserve's jurisdiction.

During 1996, individual staff members from the Reserve Banks' consumer complaint sections continued to work at the Board for several weeks at a time to gain familiarity with operations in Washington. Eleven Reserve Banks participated in the program.

### **Consumer Policies**

The Consumer Policies program explores alternatives to regulation for protecting consumers in retail financial services, and it brings research information to bear more directly on policymaking. During 1996, Consumer Policies participated in revising disclosures to aid consumers in shopping for automobile leases and also provided research analyses for reports on finance charges, home equity lines of credit, funds availability, and credit card solicitations.

The program expanded efforts to educate consumers about mutual funds, annuities, and other uninsured bank products. It produced public-service video announcements and distributed them to about 150 television stations in the top 50 markets in the United States, and at year-end it had plans to prepare public-service radio announcements for distribution to 2,200 stations. The mutual funds education program won the Outstanding Educational Program Award for 1996 from the Association

for Financial Counseling and Planning Education.

In 1996 the Consumer Policies staff began to develop plans for a major consumer education initiative to complement the Board's issuance of a revised Regulation M. The educational program, which will be developed in cooperation with industry organizations, regulatory agencies, and consumer groups, is expected to be fully operational by October 1, 1997, when compliance with the new rules becomes mandatory for all lessors.

### **Consumer Advisory Council**

The Consumer Advisory Council convened in March, June, and October to advise the Board on matters concerning consumer credit protection laws and on other issues dealing with financial services to consumers. The council's thirty members come from consumer and community organizations, financial and academic institutions, and state government. Council meetings are open to the public.

The Council discussed the implementation of CRA at each of the three meetings. In March, members listed emerging issues related to the revised CRA rules, including the degree to which communities will be part of the examination process; the need for timely, easy access to examination schedules and CRA evaluations; difficulties in analyzing small banks' files for loan distribution by income because information is not always available; and the possibility that, because of the new emphasis on lending numbers, some institutions might give less attention to community work. Members also expressed concerns about the impact of mergers and acquisitions on communities and discussed possible strategies for dealing with the difficulties.

In the council's June meeting the CRA focus was on small-bank examinations. Council members reported experience under the new rules that was largely positive. They found that examinations were more performance oriented and examiners' time on site had been reduced. The council also discussed the availability of data on small business and farm loans. The council members were reminded that data on a census-tract basis remains at the financial institution and will be reported to the public only on an aggregated basis.

In the October meeting, some members expressed concern that a greater CRA emphasis on lending could create a disincentive for financial institutions to make important community development investments whereas, for some neighborhood revitalization projects, equity investments and loans to moderate- and upper-income households are essential to successful economic integration. The council also discussed a Board proposal to amend Regulation Y (Bank Holding Companies) designed to streamline the application process for mergers and acquisitions. Consumer and community group advocates voiced strong concerns about proposed revisions that would shorten the times available for informal discussions with the applicants.

In 1995 the council had established a task force to explore ways to improve the mortgage loan process for consumers and the industry in light of the vast number of documents typically presented for the consumer to review and sign at closing. The work was undertaken at a time when the Congress had introduced bills to consolidate rulewriting authority for most mortgage-related disclosures with the Federal Reserve Board. In October 1996, after a year-long study, the task force submitted its final report to the council.

The report concluded that streamlining mortgage closings is easier in concept than in practice. The task force found that, whereas the perception may be otherwise, most closing or settlement documents are in fact produced for reasons other than federal requirements. Many result from lender practices, state or local laws, or secondary market requirements; others result from "an abundance of caution" on the part of the lender, and are meant to protect against future legal claims from consumers.

Out of fifty-four documents associated with a conventional, fixed-rate, thirty-year mortgage, for example, the task force found that twelve were required by federal laws or regulations such as the Board's Regulation B (Equal Credit Opportunity) and Regulation Z (Truth in Lending) or HUD's Regulation X (Real Estate Settlement Procedures). These twelve, the task force suggested, could possibly be reduced to five—for example, by consolidating notices about mortgage servicing, flood hazard, right to an appraisal, and controlled business arrangement.

The report also suggested undertaking a broad study of consumer experiences to determine whether "information overload" at settlement is a concern and whether required disclosures currently given at settlement are necessary or should be provided earlier in the application process. Other recommendations were to develop a single disclosure based on good-faith estimates of closing costs and other terms to be updated at settlement; to prohibit addenda to the good-faith estimate and the itemization of the amount financed; and to develop an educational piece identifying the documents used in a typical loan closing.

Council members discussed the Board's approach to consumer leasing disclosures in March and June. Leasing

represents 25 percent to 30 percent of retail sales of autos in the United States and about 65 percent of retail sales of luxury cars. Members discussed the disclosures required under the Board's Regulation M (Consumer Leasing), including such issues as whether requiring disclosure of a lease rate (one not entirely comparable to an annual percentage rate in credit transactions) would be helpful to consumers; how best to alert consumers to the financial consequences of terminating a lease early; and the need for consumer education to ensure that consumers understand the differences between leasing and purchasing an automobile.

In June the council discussed the coverage of EBT (electronic benefit transfer) programs under the EFT act and Regulation E. The council adopted a resolution expressing concern that a statutory exemption being considered by the Congress could leave benefit recipients unprotected, and it urged the Board to support provisions protecting recipients from losses. (The Congress subsequently enacted the Personal Responsibility and Work Opportunity Act of 1996, creating an exemption from Regulation E for needs-tested benefits if the programs are established or administered by state or local governments.)

The council discussed the potential coverage of stored-value cards at all three meetings. In March, members talked about the different kinds of cards being developed and the types of protections that might apply. Overall, members agreed on the need for balance to provide consumers with reasonable protections without putting domestic businesses at a disadvantage in a global market where the technology is changing daily. In June, the council discussed the Board's proposed rule to require disclosures for certain stored-value products, mentioning potential security and other

risks to the banking system. In October, members continued the discussion, noting the difficulty of developing rules for products that do not yet exist or that quickly evolve. Generally, members supported a basic level of mandatory disclosures for all stored-value cards.

Other topics on the council's agenda during 1996 included home equity lines of credit and the disclosure of finance charges (and associated tolerances) under the Truth in Lending Act; electronic banking and ATM surcharges and fees; and issues arising from a proposed substitution of a dollar coin for the dollar bill.

Roundtable discussions, known as the Members Forum, were held at each meeting and gave council members the opportunity to offer their views on their industries or localities.

### **Testimony and Legislative Recommendations**

The Board twice addressed issues related to the coverage of electronic benefit transfer (EBT) programs by the Electronic Fund Transfer Act and Regulation E, submitting a statement in March to the House Committee on Banking and Financial Services and testifying in June before that committee's Subcommittee on Financial Institutions and Consumer Credit.

In 1995 the Congress had passed, but the President had vetoed, a bill exempting from Regulation E any needs-based benefits established or administered by the states.<sup>11</sup> In the absence of such legislation, Regulation E coverage of EBT programs was to become mandatory on March 1, 1997; and even though the Board had established a modified set of rules for EBT programs, many states

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11. The President's veto of the bill was unrelated to the EBT provisions.

continued to express concern about the potential impact.

In its invited statement the Board reiterated a belief that coverage of EBT programs was required under the EFTA but also suggested that a congressional reexamination of the scope of the EFTA could take account of developments since its enactment in 1978 and balance competing objectives in light of changing national priorities. The Board noted also that if an exemption were limited to particular categories or to state-administered programs, the existence of different rules could make it difficult to implement the one-card, unified national delivery system envisioned by the Federal Electronic Benefits Transfer Task Force.

In its June testimony the Board reiterated its suggestion that to the extent the Congress found it necessary to balance the EFTA's consumer protection against concern about compliance costs on the nationwide delivery of EBT, the Congress might reexamine the scope of the law's coverage. The Congress subsequently enacted the Personal Responsibility and Work Opportunity Act of 1996, which exempts needs-tested EBT programs that are established or administered by state or local governments; federal and other state programs remain subject to Regulation E.

In April the Board testified before the House Subcommittee on Financial Institutions and Consumer Credit on proposed legislation regarding the disclosure of fees imposed on ATM transactions. The Board's testimony on ATM fees focused on the current regulatory scheme regarding fee disclosures, data about consumer complaints, the level of compliance with the EFTA found in bank examinations, and the incidence and amount of ATM transaction fees reported in Federal Reserve surveys.

Regulation E requires disclosure of fees imposed by an institution on its own customers but does not require the institution to disclose ATM surcharges imposed by others, since it would be impractical to monitor and disclose the dollar amount of a surcharge that might be imposed at any given time by some other institution nationwide. A surcharge imposed at an ATM must be disclosed on a sign posted at the terminal or displayed on the screen, and institutions are encouraged to give customers the option to cancel the transaction after receiving notice of the fee.

Data on examinations of financial institutions show general compliance with Regulation E and few violations of fee disclosures. Consumer complaint data suggest few problems with electronic transfers generally or with ATM fees.

The Board commented on two bills. The first, H.R. 3246, would have required disclosure at ATMs of all fees imposed in connection with a transaction, whether imposed by the ATM operator, the account-holding institution, or a national, regional, or local network. The Board noted that Regulation E, network operating rules, and laws in a number of states already require fee disclosures and therefore the proposed legislation might be unnecessary. The Board also questioned whether it is operationally feasible for an operator of an ATM to disclose fees imposed by the thousands of account-holding institutions whose customers have access to the ATM.

H.R. 3221 would have prohibited ATM surcharges. Suggesting that substantive limitations on prices are better left to state legislatures, the Board noted that in fact few states have set limits on ATM surcharges. The Board observed that a prohibition might deter financial institutions and other ATM operators

from making ATMs widely available to consumers. Also, a prohibition would not necessarily keep costs down for consumers, as ATM operators could negotiate through the networks for an increase in the amount they receive, and such an increase could be passed on via the account-holding institution to its customers.

### **Recommendations of Other Agencies**

Each year the Board asks for recommendations from the federal supervisory agencies for amending the financial services laws or the implementing regulations.

The OCC recommended that the Congress generally review and consider alternatives for providing useful but less burdensome disclosures, suggesting that the current disclosures are unnecessarily burdensome on banks and insufficiently beneficial to consumers.

The agency also encouraged the Board to clarify Regulation B's prohibition against discrimination based on national origin and issues related to credit scoring systems; and to clarify whether creditors may follow agency regulations for the voluntary collection of restricted information without violating Regulation B. The OCC also asked for Board reconsideration of its decision not to modify the prohibition on collecting monitoring information in nonmortgage loans. Finally, the OCC asked the Board to clarify the rule under Regulation Z for the treatment of fees paid by a consumer for optional services; in the agency's view, such fees should not be included in the finance charge unless expressly stated in the regulation.

The FDIC noted its 1996 testimony on proposed amendments to the Equal Credit Opportunity Act (implemented by the Board's Regulation B), the

Electronic Fund Transfer Act (Regulation E), the Consumer Leasing Act (Regulation M), and the Truth in Lending Act (Regulation Z). The testimony supported allowing the voluntary collection of data for all credit transactions; expressed concerns that open-end credit plans generally and credit card lending specifically raised safety and soundness issues; and stated a need to address solicitation and marketing practices that may comply with the letter of the requirements of consumer-protection regulations but that, in the agency's view, constitute "bait and switch" tactics. ■