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A FEDERAL RESERVE SYSTEM PUBLICATION FOCUSING ON CONSUMER COMPLIANCE TOPICS

Inside

Top Federal Reserve Compliance Violations in 2022 Under the Fair Credit Reporting Act and the Equal Credit Opportunity Act

By Dolores Collazo, Senior Financial Institution Policy Analyst, Board of Governors of the Federal Reserve System

As announced in the First Issue 2023, *Consumer Compliance Outlook* (*CCO*) is regularly publishing data-driven articles that leverage the Federal Reserve System's supervisory information from consumer compliance examinations of state member banks.[1] The articles analyze this information at an aggregate level to review top-cited violations, root causes, common pitfalls, and sound practices to mitigate risks.

As the Federal Reserve examination data in **Table 1** (page 8) indicate, the top consumer compliance violations in 2022 include violations of Regulation B, which implements the Equal Credit Opportunity Act (ECOA), and provisions of the Fair Credit Reporting Act (FCRA). More specifically, the violations involved the adverse action notice (AAN) requirements of Regulation B and the FCRA, the Regulation B spousal signature requirements for individual, creditworthy applicants, and the Regulation B requirement to provide a copy of all appraisals and other written valuations to applicants for a first-lien, dwelling-secured mortgage, as well as a notice of the right to obtain these documents not later than three business days after receiving an application for credit secured by a first lien on a dwelling.

This is a two-part article: The first section discusses the technical regulatory requirements, the root causes of violations, and common pitfalls, while the second section discusses sound practices and compliance management system enhancements that may mitigate the risks of violating these provisions.

PART 1 — COMMON FCRA AND ECOA VIOLATIONS

The format for the common violations articles is to first list the regulatory requirements (either by quoting the verbatim text or by summarizing it) and then discuss the violations, root causes, and sound practices.

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Consumer Compliance Outlook is distributed to state member banks and bank and savings and loan holding companies supervised by the Board of Governors of the Federal Reserve System.

Top Federal Reserve System Violations in 2022: Regulation E Error Resolution Requirements and Regulation X Escrow Account Requirements

By Kate Loftus, Examiner, Federal Reserve Bank of Minneapolis

As discussed in the cover article in this issue, *CCO* is regularly publishing articles that leverage Federal Reserve supervisory data. The 2022 data (see the table on page 8) reveal that violations of the Electronic Fund Transfer Act (Regulation E) and the Real Estate Settlement Procedures Act (Regulation X) were among the most cited consumer compliance violations in examinations of state member banks in 2022. This article discusses violations of Regulations E and X, examiner observations, and sound practices to mitigate associated compliance risks.

REGULATORY REQUIREMENTS

Regulation E — Electronic Fund Transfer Act
12 C.F.R. §1005.11(c) Time Frames for Investigating Errors

Ten business days: A financial institution shall promptly investigate and determine whether an error occurred within 10 business days of receiving a notice of error (20 business days if the notice of error involved an electronic fund transfer (EFT) to or from a new account within 30 days after the first deposit to the account was made).[1] The bank is not required to provide provisional credit.

Forty-five days: If the institution cannot complete an investigation within 10 business days (20 business days for a new account), it may take up to 45 days from receipt of a notice of error to investigate and determine if an error occurred, provided the institution:[2]

- provisionally credits the consumer's account for the amount of the alleged error within 10 business days of receiving the error notice;[3] and
- informs the consumer within two business days after provisional crediting and provides full use of the funds during the investigation.[4]

Ninety days: An institution may take up to 90 days in place of 45 days to complete an investigation if a notice of error involves an EFT that was not initiated within the state, resulted from a point of sale debit card transaction, or occurred within 30 days after the first deposit to the account was made.[5] The bank is required to provide provisional credit.

The Electronic Fund Transfer Act (EFTA), as implemented by Regulation E, provides the legal framework for the rights, liabilities, and responsibilities of participants in EFTs involving a consumer's checking, savings, or other asset account held by a financial institution.[6]

If a consumer notifies a financial institution that an *error* occurred with an EFT, the institution must investigate and notify the consumer of its findings and the action taken to resolve the error. The regulation defines an *error* as follows:

- an unauthorized EFT;
- an incorrect EFT to or from the consumer's account;
- the omission of an EFT from a periodic statement;
- 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 §1005.9 or §1005.10(a); or
- the consumer's request for documentation required by the regulation or for additional information or clarification concerning an EFT, including a request the consumer makes to determine whether an error exists under the regulation.[7]

The regulation further clarifies this definition by providing these examples of inquiries that are not errors:

- a routine inquiry about the consumer's account balance;
- a request for information for tax or other recordkeeping purposes; or
- a request for duplicate copies of documentation.

Section 1005.11(c) requires institutions to investigate errors within certain time frames as applicable. Examiners commonly observed these violations and the underlying causes:

- **Not promptly investigating.** Examination reports indicate some financial institutions were not promptly initiating error resolution investigations after the consumer notified them of an error, in violation of §1005.11(c). These errors typically occurred because bank staff did not recognize when consumers were making error resolution claims, did not know how to initiate investigations, or did not correctly identify all of the disputed transactions.
- **Not providing provisional credit.** Examiners cited institutions for violating §1005.11(c)(2)(i) by not providing provisional credit for the amount of the alleged error within 10 business days of receiving an error notice when the institutions could not complete their investigation within 10 business days and took up to 45 days to investigate under §1005.11(c)(2). Examiners also cited institutions that provisionally credited accounts but failed to provide full access to and use of the funds during the investigation. These errors occurred because the institutions lacked effective procedures, controls, monitoring, and/or training to ensure compliance with the regulation.
- **Not conducting an adequate investigation.** Examiner data also showed some institutions conducting inadequate investigations of error claims. As stated in a prior *CCO* article: "A financial institution cannot deny a consumer's claim of an error without conducting a reasonable investigation, unless it corrects the error as alleged by the consumer. A reasonable investigation includes reviewing relevant information within the institution's records. If this review confirms the error, the claim cannot be denied. When the alleged error is an unauthorized EFT, the EFTA places the burden of proof on the financial institution to establish the transaction was authorized.[8] Therefore, if the institution cannot establish the disputed EFT transaction was authorized, the institution must credit the consumer's account."[9]

These errors occurred because staff either did not review or research all the transactions the consumer disputed or denied claims because of prior disputed transactions with the same merchant. Examiners identified root causes as not providing effective policies and procedures and not conducting adequate training and monitoring.

REGULATORY REQUIREMENTS

Regulation E — Electronic Fund Transfer Act
12 C.F.R. §1005.11(d) Procedure When an Error Did Not Occur or Did Not Occur as Alleged

After an institution completes its investigation, if it determines an error did not occur, or one occurred that differs in the manner or amount the consumer alleged, the institution must notify the consumer in writing of the results of its investigation and the consumer's right to request the documents the institution relied on in making its determination.[10] If the institution debits a provisional credit, it must also notify the consumer of the date and amount of debiting and that the institution will honor checks, drafts, or similar instruments payable to third parties and preauthorized transfers from the consumer's account for five business days after the notification (without charge to the consumer as a result of an overdraft).[11]

Examiners cited institutions for not explaining the results of an investigation and not providing a notice to the consumer of the right to request the documents the institution relied on in making its determination. These errors occurred primarily because staff did not adhere to the institution's policies and procedures.

SOUND PRACTICES TO MITIGATE REGULATION E RISKS

Sound practices can help limit these types of violations, including:

- **Providing enhanced procedures.** Adopting sufficiently detailed error resolution procedures can help ensure staff comply with regulatory requirements. Procedures may include, but are not limited to, instructions for gathering sufficient and accurate information upon notice of an error by a consumer, what constitutes a thorough investigation, how consumer engagement should occur, and how to document the process throughout.

- **Conducting training.** Training is an important tool for helping to proactively prevent or minimize violations. The requirements of §1005.11 are technical and nuanced. Periodic training can help to reinforce compliance staff's understanding of the requirements and clarify any ambiguities.

- **Monitoring Regulation E compliance.** Bank management can regularly monitor the effectiveness of its controls, including Regulation E processes and procedures. To do this, bank management may consider conducting periodic reviews of notices of error, and completed investigations, to ensure that staff are adhering to established procedures and deadlines. Reviewing data points can also help identify violations. If a high percentage of error investigations are resolved in the bank's favor, the bank may want to review a sample to ensure they complied with the regulation.

- **Enhancing consumer complaint response.** Several of the Regulation E errors discussed here were identified through consumer complaints. Institutions can regularly review complaint activity to identify and address Regulation E errors that may not have been identified through monitoring reviews to help ensure compliance.

REGULATORY REQUIREMENTS

Regulation X — Real Estate Settlement Procedures Act 12 C.F.R. §1024.17(c) Escrow Requirements

Section 17(c) specifies the procedures for administering an escrow account, including the following requirements:

- Payments generally cannot not exceed the "target balance," which is defined as "the estimated month end balance in an escrow account that is just sufficient to cover the remaining disbursements from the escrow account in the escrow account computation year, taking into account the remaining scheduled periodic payments, and a cushion, if any," which cannot exceed one-sixth of the estimated total payments from the escrow account, with certain exceptions in the case of a shortage or deficiency.
- "Before establishing an escrow account, the servicer must conduct an escrow account analysis to determine the amount the borrower must deposit into the escrow account…, and the amount of the borrower's periodic payments into the escrow account," subject to the limitations discussed above.[12]
- Thereafter, the servicer must conduct an escrow account analysis at the end of the escrow account computation year to determine the borrower's monthly escrow account payments for the next computation year and use that analysis to determine whether a surplus, shortage, or deficiency exists and make required adjustments as appropriate.[13]
- A servicer may issue a short-year annual escrow account statement to change one escrow account computation year to another. The short-year statement must end the escrow account computation year and establish the beginning date of the new escrow account computation year. The servicer shall deliver the short-year statement to the borrower within 60 days from the end of the short year.[14]
- If a surplus exists, which is defined as a balance in excess of the target balance for the account, it must be refunded within 30 days from the date of the analysis if it is $50 or greater. If the surplus is less than $50, the servicer can either refund it within 30 days or credit it to the escrow account for the next year.[15]
- The aggregate accounting method must be used to conduct the escrow account analyses.[16]
- Where the borrower is required to make payments to an escrow account, the servicer must also ensure it makes timely disbursements "on or before the deadline to avoid a penalty, as long as the borrower's payment is not more than 30 days overdue."[17]
- If an escrow disbursement is billed for periods longer than one year (for example, a flood insurance premium payable every three years), the servicer must estimate the borrower's payments for a full cycle of disbursements (using the flood premium example, by dividing the three-year period into 36 monthly payments).[18]

The Real Estate Settlement Procedures Act (RESPA),[19] as implemented by Regulation X, provides the legal framework of consumer protections for the servicing of *federally related mortgage loans*, as defined in 12 C.F.R. §1024.2(b).[20] These protections include the procedures in §17(c) servicers must follow for a federally related mortgage loan with an escrow account, which lenders may require to pay real estate taxes, insurance premiums, and other mortgage-related disbursements.

Examiners frequently found bank staff inaccurately computed and disclosed the initial and annual escrow analyses. Incorrect system settings and payment amount issues typically caused these errors. For the system settings, bank staff erroneously used the payment *due date* rather than the *anticipated disbursement date* as the disbursement date for escrow items on the initial and annual escrow analyses. Using the payment due date rather than the anticipated disbursement date resulted in computation and disclosure errors on the initial and annual escrow account analyses. For the payment amount issue, bank staff itemized the incorrect number of payments from the escrow account on the initial and annual escrow account analyses, resulting in inaccurate initial and annual escrow computations and projections.

> "Given the technical nature of escrow-related rules, adopting sufficiently detailed escrow procedures is important to help ensure bank staff set up and manage escrow accounts appropriately."

Examiners also observed errors related to bank staff conducting annual escrow account analyses beyond the 12-month computation year, without issuing short-year statements as required under the regulation. In these cases, staff conducted annual escrow analyses for all loans during the same month. If a loan was originated outside of this month, an annual escrow account analysis was not prepared until the loan aligned with the bank's escrow analysis schedule. This resulted in staff not conducting timely annual escrow account analyses, as §1024.17(c)(3) requires.

SOUND PRACTICES TO MITIGATE RESPA RISKS

Several sound risk management practices can facilitate compliance with escrow account requirements:

- **Increasing oversight.** Implementing approval processes and/or secondary levels of review for changes to system settings, for example, is one way to help ensure compliance with the regulation.
- **Enhancing escrow procedures**. Given the technical nature of escrow-related rules, adopting sufficiently detailed escrow procedures is important to help ensure bank staff set up and manage escrow accounts appropriately and provide accurate and timely disclosures to borrowers.
- **Conducting regular training.** Providing regular and detailed training on escrow-related rules, particularly for mortgage origination and servicing staff, can help to ensure that staff understand how to manage the escrow accounts appropriately and comply with regulatory requirements. Additionally, institutions may want to consider establishing a training schedule with appropriate training frequency, as well as a tracking mechanism to ensure required trainings are satisfactorily completed.

CONCLUSION

This article discussed the most common Regulation E and X violations from 2022 and sound risk management practices institutions can consider to help mitigate compliance risk. Specific issues and questions related to these regulations should be raised with your primary regulator. ■

Resources

- Richele S. Brady, "Escrow Accounting Rules: Are You in Compliance?," *CCO* (Second Issue 2018)
- Kenneth Benton and Robert Sheerr, "Error Resolution Procedures and Consumer Liability Limits for Unauthorized Electronic Fund Transfers," *CCO* (Fourth Quarter 2012)
- Scott Sonbuchner, "Error Resolution and Liability Limitations Under Regulations E and Z: Regulatory Requirements, Common Violations, and Sound Practices," *CCO* (Second Issue 2021)
- Kathleen Benson, "Enhancing Your Compliance Training Program," *CCO* (First Issue 2019)
- RESPA Interagency Examination Procedures
- EFTA Interagency Examination Procedures

Endnotes*

1 12 C.F.R. §1005.11(c)(1) and (c)(3)(i).

2 12 C.F.R. §1005.11(c)(2).

3 12 C.F.R. §1005.11(c)(2)(i).

4 12 C.F.R. §1005.11(c)(2)(ii).

5 12 C.F.R. §1005.11(c)(3)(ii).

6 12 C.F.R. §1005.2(b)(1).

7 12 C.F.R. §1005.11(a).

8 15 U.S.C. §1693g(b).

9 Scott Sonbuchner, "Error Resolution and Liability Limitations Under Regulations E and Z: Regulatory Requirements, Common Violations, and Sound Practices," *CCO* (Second Issue 2021).

10 12 C.F.R. §1005.11(d)(1).

11 12 C.F.R. §1005.11(d)(2).

12 12 C.F.R. §1024.17(c)(2).

13 12 C.F.R. §1024.17(f) and (c)(3). An exception applies if a servicer is issuing a short-year statement to change one escrow account computation year to another. See 12 C.F.R. §1024.17(i)(4).

14 12 C.F.R. §1024.17(i)(4)(i).

15 12 C.F.R. §1024.17(f)(2)(i).

16 12 C.F.R. §1024.17(c)(4).

17 12 C.F.R. §1024.17(k)(1).

18 12 C.F.R. §1024.17(c)(9).

19 12 U.S.C. §2601 et seq.

20 12 C.F.R. §1024.5(a), (b), and (d).

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

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Top Federal Reserve Compliance Violations in 2022 Under the Fair Credit Reporting Act and the Equal Credit Opportunity Act

REGULATORY REQUIREMENTS

Fair Credit Reporting Act
Adverse Action Notice Requirements §615(a)
Duties of users taking adverse actions on the basis of information contained in consumer reports

If a user of a consumer report takes adverse action, as defined in FCRA §603(k), with respect to any consumer based, in whole or in part, on information in the report, the user must provide the consumer an AAN with the following information:

- Notice of the adverse action taken based on information obtained from a consumer reporting agency
- Notice of the consumer's right to:
    - Obtain a free copy of the person's consumer report from the consumer reporting agency providing the information if requested within 60 days
    - Dispute with a consumer reporting agency the accuracy or completeness of any information in a consumer report furnished by the consumer reporting agency
- The name, address, and telephone number of the consumer reporting agency that furnished the report to the person
- A statement that the consumer reporting agency did not make the credit decision and is unable to provide to the consumer the specific reasons why the adverse action was taken

If a credit score was a factor in taking adverse action, the following information must be provided:

- The numerical credit score used and the date on which it was created
- The range of possible credit scores under the model used
- The key factors that adversely affected the credit score
- The name of the person or entity providing the credit score or the information upon which score was created

Examiners cited violations for not providing an accurate or complete AAN to affected applicants. Common violations included:

- Not including the range of possible credit scores under the scoring model used. Disclosing the range of scores is critical because different models use different ranges.
- Not providing an AAN when taking adverse action based, in whole or in part, on information in a consumer report.
- Taking adverse action based, in whole or in part, on a credit score, but not including the credit score disclosures specified in FCRA §609(f)(1) in the AAN. The credit score does not have to be the primary reason adverse action is taken. *The credit score disclosures are required whenever a score is used in the decision to take adverse action.*

Common issues include inadequate training, controls, and procedures.

An FCRA AAN alerts consumers that adverse action was taken because of negative information in their credit reports and provides them the right to obtain a free copy of their reports so they can review them and file disputes if the reports contain inaccurate information.[2] To comply, users of consumer reports and credit scores must know the scope of transactions subject to FCRA AAN requirements.

For credit transactions, the FCRA applies the definition of *adverse action* in §701(d)(6) of the ECOA.[3] This includes taking adverse action on an existing credit account.[4] For example, many creditors periodically conduct reviews of their consumer accounts, which often include pulling credit reports. Suppose, for example, a credit card issuer reviews the credit reports of its consumer accounts and reduces the credit limit for any account showing 60-day or 90-day late payments with other creditors. Because the creditor is taking adverse action on a credit account based, in whole or part, on information in a consumer report, an FCRA AAN is required.

For noncredit transactions, FCRA adverse action includes taking negative action, based, in whole or in part, on information in a consumer report, for:

- an existing noncredit account during account review to determine if the consumer continues to meet the terms of the account;

TABLE 1: Top Consumer Violations in 2022 for State Member Banks

	Provision	Violations	% of All Violations
1	Regulation C (Home Mortgage Disclosure Act), 12 C.F.R. §1003.4(a): requires a financial institution to collect specific data on applications for covered loans it receives, originates, and purchases for each calendar year.	239	59.4
2	Regulation BB (Community Reinvestment Act), 12 C.F.R. §228.42(a): requires a bank to collect and maintain specific data for each small business or small farm loan originated or purchased by the bank.	29	7.2
3	Regulation E (Electronic Fund Transfers Act), 12 C.F.R. §1005.11(c): requires a financial institution to perform an investigation and determine whether an error occurred within 10 business days of receiving a notice of error.	9	2.2
4	Regulation E (Electronic Fund Transfers Act), 12 C.F.R. §1005.11(d): requires a financial institution to respond to a consumer's notice of error in writing if it determines no error occurred or an error occurred in a manner or amount different from the one the consumer described.	6	1.5
5	(tie) Fair Credit Reporting Act, 15 U.S.C. §1681m(a): requires a financial institution taking adverse action against a consumer based in whole or in part on information in a consumer report to provide an adverse action notice.	5	1.2
6	Regulation B (Equal Credit Opportunity Act), 12 C.F.R. §1002.7(d): prohibits a creditor from requiring the signature of an applicant's spouse or other person, other than a joint applicant, on any credit instrument if the applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of the credit requested.	5	1.2
7	Regulation B (Equal Credit Opportunity Act), 12 C.F.R. §1002.9(a): requires a creditor to notify an applicant within 30 days after receiving a completed application concerning the creditor's approval of, counteroffer to, or adverse action on the application.	5	1.2
8	Regulation B (Equal Credit Opportunity Act), 12 C.F.R. §1002.14(a): requires a creditor to provide an applicant a copy of all appraisals and other written valuations developed in connection with an application for credit that is to be secured by a first lien on a dwelling.	5	1.2
9	Regulation X (Real Estate Settlement Procedures Act), 12 C.F.R. §1024.17(c): sets limits on the amount a servicer can require a borrower to deposit into any escrow account created in connection with a federally related mortgage loan.	5	1.2

Note: These data were based on 211 examinations, in which examiners cited 402 violations.

- applications and transactions initiated by a consumer, such as a consumer applying to a financial institution to open a checking account;
- insurance policies; and
- employment decisions.[5]

When a creditor is required to provide AANs under both the FCRA and ECOA/Regulation B, the notices may be combined to facilitate compliance and reduce regulatory burden. Model AANs are available in Appendix C of Regulation B (forms C-1 through C-6), including combined FCRA/ECOA forms.

REGULATORY REQUIREMENTS

Regulation B — Equal Credit Opportunity Act
12 C.F.R. §1002.9(a) Notification of action taken, ECOA notice, and statement of specific reasons

(1) When notification is required. A creditor shall notify [a consumer] applicant of action taken within:

(i) 30 days after receiving a completed application concerning the creditor's approval of, counteroffer to, or adverse action on the application;

(ii) 30 days after taking adverse action on an incomplete application, unless notice is provided in accordance with paragraph (c) of this section;

(iii) 30 days after taking adverse action on an existing account; or

(iv) 90 days after notifying the applicant of a counteroffer if the applicant does not expressly accept or use the credit offered.

In contrast to the FCRA, which is generally limited to consumer transactions, Regulation B adverse action requirements apply to both consumer and business transactions. For these provisions, examiners cited financial institutions for failing to provide timely AANs in accordance with the regulation. A creditor must provide an AAN to the applicant within 30 days after receiving a complete credit application. This requires bank staff to know when a credit application is "complete." The commentary clarifies that a *completed application* is defined "in terms that give a creditor the latitude to establish its own information requirements."[6] Thus, members of an institution's lending staff must ensure they understand their institution's definition of a completed application, which starts the 30-day clock if adverse action is being taken.

> "If the applicant provides sufficient data for a credit decision, even though information is missing, the creditor may evaluate the application, make its credit decision, and notify the applicant accordingly. If credit is denied because the application is incomplete, an AAN is required."

For business credit applications, §1002.9(a)(3)(ii) provides these requirements:

- For businesses with gross revenues of $1 million or less in the preceding fiscal year, the general adverse action requirements apply, except that:
  - the notice of action taken may be given orally or in writing;
  - the creditor may disclose an applicant's right to the statement of reasons at the time of application instead of when adverse action is taken, if the creditor lets the applicant know they have 60 days to request the reasons, and the disclosure includes the ECOA notice; and
  - for an application taken entirely by telephone, the creditor may provide an oral statement of the action taken and the applicant's right to the statement of reasons for adverse action.[7]
- Businesses with gross revenues greater than $1 million in the preceding fiscal year must:
  - notify the applicant, within a reasonable time, orally or in writing, of the action taken; and
  - provide the statement of reasons for adverse action in writing and the ECOA notice if the applicant makes a written request for the reasons within 60 days of the notice.[8]

Also, if the applicant provides sufficient data for a credit decision, even though information is missing, the creditor may evaluate the application, make its credit decision, and notify the applicant accordingly. If credit is denied because the application is incomplete, an AAN is required.[9] If the creditor requires additional information, it may send a notice of incompleteness.[10]

In addition to the timing requirements, the violations cited involved not providing an accurate and complete AAN. Financial institutions should remember that AANs should include the following information:

- The specific reasons for the action taken[11]
- The creditor's name and address
- The ECOA notice regarding prohibited discrimination
- The name and address of the creditor's federal agency that administers compliance

Instead of providing the reasons for the action taken, a creditor may provide a disclosure of the applicant's right to receive the specific reasons. For this option, the notice must indicate that the applicant should request the reasons within 60 days of the disclosure date. The creditor should respond within 30 days of the applicant's request.

The root causes of these violations include inadequate training and failing to implement controls to ensure procedures are consistently followed.

REGULATORY REQUIREMENTS

Regulation B — Equal Credit Opportunity Act
12 C.F.R. §1002.7(d) Signature of spouse or other person

(1) Rule for qualified applicant. Except as provided in this paragraph, a creditor shall not require the signature of an applicant's spouse or other person, other than a joint applicant, on any credit instrument if the applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of the credit requested. A creditor shall not deem the submission of a joint financial statement or other evidence of jointly held assets as an application for joint credit.

Examiners cited financial institutions that required individual, creditworthy applicants to obtain the signature of their spouse or another person as a condition of their loan in violation of the regulation. Comments 7(d)(1)-1, -2, and -3 to Regulation B clarify the requirements for evaluating individual, creditworthy applicants:

- The creditor cannot require the applicant to provide a cosigner.
- A "joint applicant" is someone who applies contemporaneously with the applicant for joint credit, not someone required as a condition for the loan.
- A person's intent to be a joint applicant must be evidenced at the time of application. Signatures on a joint financial statement confirming the information is accurate and complete are not sufficient to establish intent to apply for joint credit.

The regulation has an exception when a loan is secured by collateral jointly owned with a spouse, and the spouse's signature is necessary under state law to reach the collateral in the event of default.[12] If state law requires the spouse's signature on both the security instrument *and* the note, the creditor may require the spouse's signature on both. But if state law requires the spouse's signature only on the security instrument, the creditor may not require the spouse to cosign or guarantee the note evidencing the credit agreement.[13]

The root causes of these violations include inadequate training and the lack of controls to ensure that procedures are properly implemented.

REGULATORY REQUIREMENTS

Regulation B — Equal Credit Opportunity Act
12 C.F.R. §1002.14(a) Providing appraisals and other valuations

(1) In general. A creditor shall provide an applicant a copy of all appraisals and other written valuations developed in connection with an application for credit that is to be secured by a first lien on a dwelling. A creditor shall provide a copy of each such appraisal or other written valuation promptly upon completion, or three business days prior to consummation of the transaction (for closed-end credit) or account opening (for open-end credit), whichever is earlier. …

(2) Disclosure. For applications subject to paragraph 14(a)(1) of this section, a creditor shall mail or deliver to an applicant, not later than the third business day after the creditor receives an application for credit that is to be secured by a first lien on a dwelling, a notice in writing of the applicant's right to receive a copy of all written appraisals developed in connection with the application. In the case of an application for credit that is not to be secured by a first lien on a dwelling at the time of application, if the creditor later determines the credit will be secured by a first lien on a dwelling, the creditor shall mail or deliver the same notice in writing not later than the third business day after the creditor determines that the loan is to be secured by a first lien on a dwelling.

Examiners cited financial institutions for not appropriately providing applicants a copy of appraisals or valuations[14] associated with a first-lien mortgage application. In several cases, inadequate training and inadequate procedures were the root causes.

In certain instances, applicants may waive the timing requirements prescribed in Regulation B, except where otherwise prohibited by law:

- An applicant may waive the timing requirements and agree to receive any copy at or before consummation or account opening.
- The institution must obtain a waiver at least three business days prior to consummation or account opening unless the waiver pertains only to an appraisal or valuation with clerical changes from a previous version provided to the applicant three or more business days prior to consummation or account opening.
- If an applicant provides a waiver and the transaction is not consummated or the account not opened, the institution must obtain the waiver no later than 30 days after that determination is made.

Violations were also cited for disclosure errors. In these instances, the creditor failed to mail or deliver a notice in writing of the applicant's right to receive a copy of all written appraisals or valuations developed in connection with the application, no later than the third business day after the creditor receives an application for a mortgage loan that is to be secured by a first lien on a dwelling.[15] In cases where it was not known at the time of application but was later determined during the application process that the loan would be secured by a first lien on a dwelling, financial institutions failed to provide the disclosure no later than the third business day after that determination.[16]

The root causes were often insufficient training and inadequate procedures and controls.

PART 2 — SOUND PRACTICES TO MITIGATE COMPLIANCE RISKS

The first part of this article explored the technical requirements of Regulation B and the FCRA. This part will highlight sound practices that can help institutions ensure compliance with those requirements.

Table 2 lists sound compliance practices that examiners have observed at financial institutions and recommend.

TABLE 2: Sound Compliance Practices

Board and Senior Management Oversight
• Tone at the top
• Risk identification
• Third-party oversight
	• Convey the importance of compliance to help set expectations
	• Identify inherent risks related to processing credit applications (understand risks involved with manual processes and automated processes) for:
	  o Adverse action notices (FCRA and Regulation B)
	  o Individual creditworthiness (Regulation B)
	  o Appraisals/valuations (Regulation B)
	• Ensure that third-party service providers understand and effectively perform their compliance responsibilities

Internal Controls	• Conduct a second review of AANs to identify errors missed during the initial review • Conduct a secondary review of loans subject to the appraisal requirements to ensure appraisals and notices were provided
Consumer Complaints	• Review complaints received by the institution or by the Federal Reserve Consumer Help complaint system for possible internal control weaknesses for the issues noted in this article, adjusting and strengthening processes as needed to ensure compliance

TABLE 2: Sound Compliance Practices (Continued)

Training • Current, tailored to the institution's processes, and sufficiently detailed to guide staff • Tools	• Conduct regular training on the FCRA and ECOA adverse action notice requirements and the ECOA spousal signatures and appraisal requirements, tailored to the individual contributor's role in the process • Identify and train for difficult situations in the process • Include training when regulatory changes and/or procedural weaknesses are noted • Provide flow charts and worksheets for staff

Monitoring and/or Audit (as applicable)
 	
• Tailored to the credit product offerings
	• Validate that policies and procedures and training are effective
	• Perform transaction testing/sampling:
	  o Adverse action notices for timing and content in comparison to application and source documents to confirm timing and accuracy
	  o Individual and joint credit applications to ensure that creditworthy applicants were able to apply individually and that joint applicants confirmed status at the time of application
	  o Denied and approved loans secured by first lien on dwellings to ensure applicants and borrowers were provided appraisal/valuation, as applicable

Policies and Procedures
 	
• Adequately cover the regulatory requirements and provide effective staff guidance
	• Implement detailed policies and procedures to ensure a consistent and repeatable process. Considerations might include:
	  o Understanding triggers for AANs and timing requirements
	  o Ensuring that adverse action notices include elements required by the ECOA and the FCRA, as applicable
	  o Understanding different types of credit applicants, individual versus joint
	  o Evidencing joint applicants at time of application
	  o Providing copies of appraisals and valuations for first lien dwelling loans or compliant notice of right to receive appraisal

Financial institutions should determine through a review of their product offerings which sound practices best align with their operations and risk profile.

CONCLUDING REMARKS

The discussion here of the top violations and sound practices to mitigate risks provides information to financial institutions on areas in which they may have a higher risk of violations and how to respond. Specific issues and questions should be raised with your primary regulator. ■

Resources

- Dolores Collazo, "Advanced Topics in Adverse Action Notices Under the Equal Credit Opportunity Act," *CCO* (Fourth Issue 2021)
- Sarah Ammermann, "Adverse Action Notice Requirements Under the ECOA and the FCRA," *CCO* (Second Quarter 2013)
- Carol Evans and Surya Sen, "Regulation B and Marital Status Discrimination: Are You in Compliance?," *CCO* (Fourth Quarter 2008)
- Interagency FCRA Examination Procedures
- Consumer Financial Protection Circular 2023-03, "Adverse Action Notification Requirements and Proper Use of the CFPB's Sample Forms Provided in Regulation B"
- Consumer Financial Protection Circular 2022-03, "Adverse Action Notification Requirements in Connection with Credit Decisions Based on Complex Algorithms"

Endnotes*

1 Governor Michelle W. Bowman, "Introducing Our New Format," *CCO* (First Issue 2023).

2 15 U.S.C. §1681m(a)(4). See also Senate Hearing 108-579 (May 20, 2003).

3 15 U.S.C. §1681a(k). See also §1002.2(c) of Regulation B.

4 15 U.S.C. §1691(d)(6).

5 15 U.S.C. §1681a(k)(1)(B). Congress added the catch-all provision in §1681a(k)(1)(B)(iv) to the FCRA in 1996 to overturn an FTC interpretation that stated that refusing to accept payment by check or rent an apartment based on a consumer report did not require an adverse action notice under the FCRA. See House Report No. 103-486 at 33 (1994): ("Additionally, the definition contains a catch-all phrase that makes clear that any action taken or determination made with respect to a consumer application or a consumer-initiated transaction that is adverse to the interest of the consumer constitutes an adverse action. This catch-all would include, for example, a refusal to cash a check, lease real estate, or open a new transaction account based on a consumer report. This new definition is intended to overturn a prior interpretation by the Federal Trade Commission (FTC), 55 Fed. Reg. 18826 (May 4, 1990), that refusal to accept payment by check or rent an apartment based on a consumer report does not trigger an adverse action notice under the FCRA.") See also 76 FR 41590, 41597 (July 15, 2011); and *40 Years of Experience with the Fair Credit Reporting Act: An FTC Staff Report with Summary of Interpretations* at p. 84 (2011): ("A business that takes adverse action against a consumer in a context other than credit, insurance, or employment (e.g., a residential landlord), based in whole or in part on a consumer report, must also provide an adverse action notice.")

6 See Comment 2(f)-6 of Regulation B.

7 12 C.F.R. §1002.9(a)(3)(i).

8 12 C.F.R. §1002.9(a)(3)(ii).

9 12 C.F.R. §1002.9(c)(1)(i).

10 12 C.F.R. §1002.9(c)(1)(ii) and 9(c)(2).

11 Comment 9(b)(2)-1 of Regulation B clarifies that the "regulation does not mandate that a specific number of reasons be disclosed, but disclosure of more than four reasons is not likely to be helpful to the applicant."

12 12 C.F.R. §1002.7(d)(4).

13 Comment 7(d)(4)-1 of Regulation B.

14 Regulation B defines a valuation as "any estimate of the value of a dwelling developed in connection with an application for credit," 12 C.F.R. §1002.14(b)(3).

15 12 C.F.R. §1009.14(b).

16 12 C.F.R. §1009.14(b).

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

INTERAGENCY OVERVIEW OF THE COMMUNITY REINVESTMENT ACT FINAL RULE

OCTOBER 2023

BACKGROUND

On October 24, 2023, the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (Board), and the Federal Deposit Insurance Corporation (FDIC) issued a final rule to strengthen and modernize regulations implementing the Community Reinvestment Act (CRA) to better achieve the purposes of the law. The CRA is a landmark law enacted in 1977 to address systemic inequities in access to credit. The CRA encourages federally insured banks to help meet the credit needs of the communities in which they do business, especially low- and moderate-income (LMI) communities, consistent with safe and sound operations.

To facilitate compliance, the agencies jointly published this summary. They have also hosted a webinar that explains the rule. The final rule and other supporting materials (including a press release and fact sheet) can be found on the OCC, Board, and FDIC websites.

OBJECTIVES AND KEY ELEMENTS OF FINAL RULE

The agencies recognize that the CRA regulations must evolve to address the significant changes in the banking industry that have taken place since the last comprehensive interagency update in 1995.

Building on feedback from stakeholders and research, the final rule updates the CRA regulations to achieve the following eight key objectives:

1. Strengthen the achievement of the core purpose of the statute

The rule seeks to ensure that the CRA continues to be a strong and effective tool to address inequities in access to credit. To achieve this objective, the rule

- evaluates bank engagement with LMI individuals and communities, small businesses, and small farms, including conducting separate assessments of large bank activities using four tests: (1) retail lending, (2) retail services and products, (3) community development (CD) financing, and (4) CD services.
- enhances financial inclusion by supporting Minority Depository Institutions and Community Development Financial Institutions, Native Land Areas, persistent poverty areas, and other high-need areas.
- emphasizes smaller loans and investments that can have high impact and be more responsive to the needs of LMI communities.

2. Adapt to changes in the banking industry, including the expanded role of mobile and online banking

The rule recognizes the significant changes in bank business models and how banking services are delivered, including through the use of internet and mobile banking and hybrid models that combine physical footprints with online lending. To achieve this objective, the rule

- maintains a focus on evaluating bank performance in areas where banks have deposit-taking facilities while also evaluating retail lending activities occurring in “Retail Lending Assessment Areas” outside of these areas. The new rule also provides consideration for banks’ community development activities nationwide.

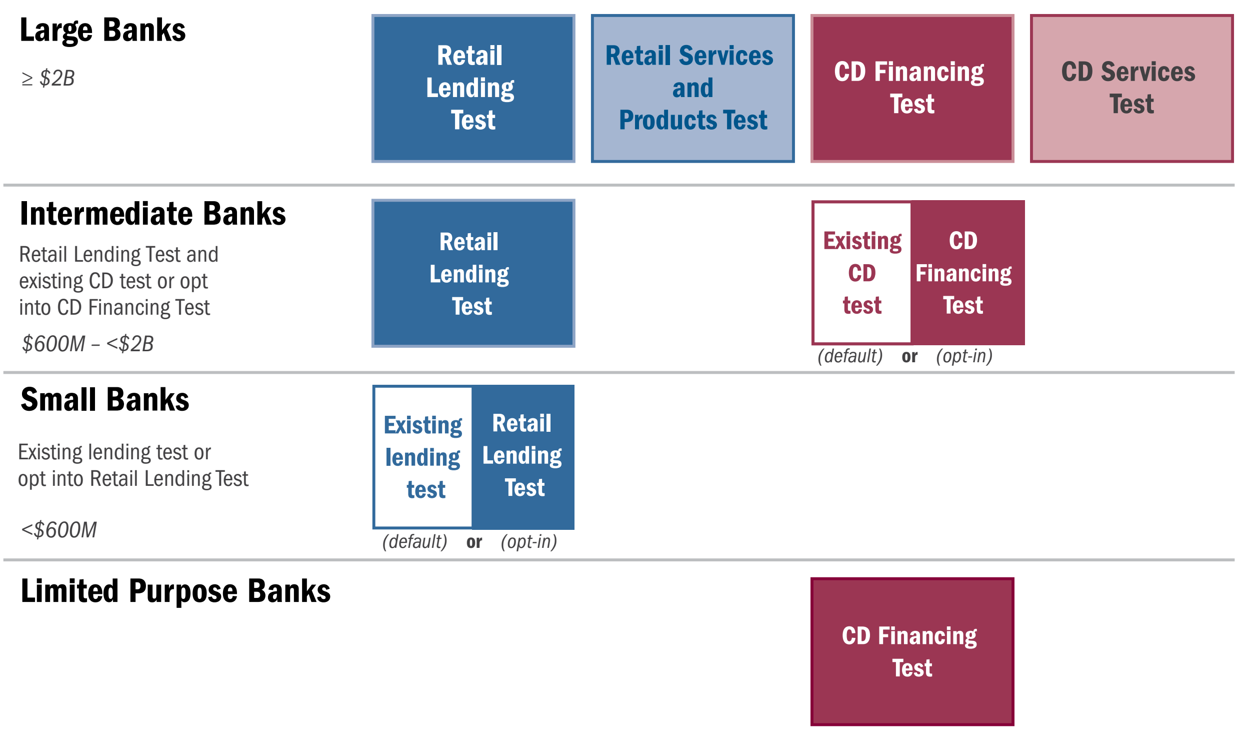
3. Provide greater clarity and consistency in the application of the regulations

The rule addresses feedback on the need for more clarity and consistency in the application of the CRA regulations. To achieve this objective, the rule

- adopts new metrics and benchmarks used by the agencies to assess retail lending performance that translate into performance conclusions.
- encourages CD activities that are responsive to the needs of LMI individuals and communities, small businesses, and small farms by clarifying what activities will receive CRA credit (such as affordable housing), providing for a public list and approval process to confirm an activity’s eligibility, and evaluating CD activities in light of their impact.

FIGURE 1: Tailored Evaluation Framework

The rule is tailored to differences in bank size and business models, with additional performance tests for large banks and flexibility for small banks to remain under the existing lending test or opt into the new Retail Lending Test. Intermediate banks also have the flexibility to remain under the existing CD test applicable to intermediate small banks under the current rule or opt into the new Community Development Financing Test. Limited purpose banks are evaluated under a tailored version of the Community Development Financing Test.



4. Tailor performance standards to account for differences in bank size, business models, and local conditions

The rule recognizes differences in bank size and business models. To achieve this objective, the rule

- updates asset size thresholds for small, intermediate, and large banks to account for changes in the banking industry: (1) small banks: <$600M (from <$376M); (2) intermediate banks: $600M–<$2B (from $376M–$1.503B); and (3) large banks: ≥$2B (from ≥$1.503B), adjusted annually for inflation.
- utilizes community and market benchmarks that reflect differences in local conditions.
- continues to provide a tailored performance evaluation framework with different performance tests based on bank size and business model (see **Figure 1**). For example, small banks will continue to be evaluated under the existing framework with the option to be evaluated under the new framework.

5. Tailor data collection and reporting requirements and use existing data whenever possible

The rule seeks to strike an appropriate balance between minimizing unnecessary burden on community banks and providing greater clarity and consistency in how large banks are assessed by establishing the use of standardized metrics for certain banks and tailoring the associated data collection, maintenance, and reporting requirements. To achieve this objective, the rule

- exempts small and intermediate banks from new data collection requirements that apply to banks with assets of at least $2 billion.

- limits certain data collection and reporting requirements to large banks with assets greater than $10 billion.

6. Promote transparency and public engagement

The rule recognizes that transparency and public engagement are fundamental aspects of the CRA evaluation process. To achieve this objective, the rule

- provides greater transparency for existing data available under the Home Mortgage Disclosure Act (HMDA) — related to the race, ethnicity, and income of bank borrowers and applicants — for large banks, by assessment area. Data will be provided on agency websites for disclosure purposes only.
- codifies the practice of forwarding to the bank all public comments received by the agencies regarding a bank's CRA performance.
- encourages the public to submit comments on community needs and opportunities.
- provides in supplementary information that the agencies will develop data tools that use reported loan data to calculate metrics and benchmarks in different geographic areas in recent years, allowing banks and the public to have additional insight into the performance standards.

7. Confirm that CRA and fair lending responsibilities are mutually reinforcing

The rule affirms that, in meeting the credit needs of their entire communities, banks must do so in a fair and equitable manner. The rule

- continues to prohibit banks from delineating facility-based assessment areas (FBAAs) that reflect illegal discrimination or arbitrarily exclude LMI census tracts.
- retains and clarifies the provision that CRA ratings can be downgraded as a result of discriminatory and other illegal credit practices.

8. Promote a consistent regulatory approach that applies to banks regulated by all three agencies

The rule recognizes the importance of consistency across the three agencies. The rule

- provides a unified approach from the three banking agencies that is responsive to feedback from stakeholders on the need for consistent regulations.

The agencies will continue their interagency work to ensure consistent implementation of a final rule through examiner and industry training, interagency examination procedures, and joint publication of an illustrative list of eligible CD activities.

KEY CHANGES IN FINAL RULE

Based on an analysis of comment letters and further agency review, the final rule includes the following key changes from the proposed rule:

1. Reduces complexity and data requirements while providing a consistent and comprehensive approach to evaluating banks under the Retail Lending Test

- reduces the number of major product lines potentially evaluated under the new Retail Lending Test from six to three: (1) closed-end home mortgage loans; (2) small business loans; and (3) small farm loans
- limits the evaluation of automobile lending to banks subject to the Retail Lending Test that
  - are majority automobile lenders (i.e., banks for which more than 50 percent of their lending comprises automobile loan purchases or originations, out of total automobile, home mortgage, multifamily, small business, and small farm lending); or
  - opt to have their automobile lending evaluated

2. Adjusts retail lending performance ranges while maintaining high standards; also increases weighting of CD financing activities

- adjusts standards to make "Low Satisfactory," "High Satisfactory," and "Outstanding" conclusions under the Retail Lending Test more achievable while still maintaining appropriate and locally calibrated standards
- for large banks, gives equal weight to retail activities and CD activities (compared to a proposed 60 percent retail/40 percent CD split). The equal weight was broadly supported by stakeholders to encourage banks to focus on CD activities in addition to retail activities by providing additional emphasis in the banks' ratings.

* Note: The links for the CRA resources discussed in this article are available on the Consumer Compliance Outlook website at consumercomplianceoutlook.org.

3. Retains evaluation of banks with significant retail lending outside of branches while increasing tailoring of the retail lending assessment area approach

- tailors requirements for delineating retail lending assessment areas (RLAAs):
  - based on recent lending patterns, about one-quarter of large bank mortgage lending and nearly 40 percent of small business lending that is outside of FBAAs would be evaluated for the first time in RLAAs
  - exempts banks with branch-based business models (banks with 80 percent or more of retail lending within facility-based assessment areas)
  - increases the loan count thresholds that would trigger RLAAs (from 100 to 150 closed-end home mortgage loans, and from 250 to 400 small business loans)
- reduces the number of product lines potentially evaluated in RLAAs: home mortgage loans or small business loans are only evaluated if the specific product line meets the triggering thresholds; other product lines are not evaluated in RLAAs
- based on agency analysis of 2018–20 CRA historical data, the agencies estimate that the changes described above would reduce by about half the number of large banks that would be required to delineate RLAAs and the number of RLAAs that would be created based on prior year lending. The approach would still evaluate banks with significant concentrations of retail loans outside facility-based assessment areas.

4. Adds metric and impact factor to evaluate bank CD investments under the CD Financing Test

- adds additional metric to CD financing evaluations, focusing on certain CD investments relative to deposits for banks greater than $10 billion, to enable examiners to evaluate bank investments under the Low-Income Housing Tax Credit and the New Markets Tax Credit programs. Strong bank performance under the metric would be a basis for positive consideration.
- creates an impact factor to recognize the important affordable housing and community development contributions of Low-Income Housing Tax Credit and New Markets Tax Credit investments

5. Provides additional flexibility under the strategic plan option while continuing to meet the credit needs of communities

- clarifies the option for any bank to request evaluation under a strategic plan and provides additional flexibility for banks with nontraditional business models
- strategic plans would need to reflect community input and meaningfully reflect that the bank seeking a plan will continue to meet the credit needs of communities if the plan diverges from the otherwise applicable performance tests

6. Addresses feedback on the need to have additional time for banks to implement the new rule

- increases the amount of time for banks to come into compliance with the new requirements (from 12 months to more than 24 months after the rule is adopted and published on the agency websites), balancing industry requests for additional time and the objective of implementing the regulations in a timely manner

7. Retains and clarifies the provision on CRA ratings downgrades

- for CRA ratings downgrades, maintains the current standard for "discriminatory or other illegal credit practices" rather than both credit and noncredit practices as proposed

8. Ensures consideration of certain small business loans under the economic development category of community development

- for certain loans to small businesses that meet a size and purpose test, allows consideration as a community development loan under economic development in addition to evaluation as a retail loan

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REGULATORY CALENDAR

EFFECTIVE DATE OR PROPOSAL DATE†	IMPLEMENTING REGULATION	REGULATORY CHANGE
01/01/26 (most provisions)	Reg. BB	Agencies issue final rule to modernize their implementing regulations for the Community Reinvestment Act
01/01/24	Reg. Z	Agencies announce dollar thresholds for smaller loan exemption from appraisal requirements for higher-priced mortgage loans
01/01/24	Regs. M and Z	Agencies update annual dollar amount thresholds for Regulations M and Z
01/01/24	Regs. C and Z	Consumer Financial Protection Bureau (CFPB) adjusts annual dollar amount thresholds under the Truth in Lending Act and the Home Mortgage Disclosure Act
11/17/23	12 C.F.R. 1090	CFPB issues proposed larger-participants rulemaking for the market for general-use digital consumer payment applications
11/14/23	Reg. II	Federal Reserve proposes to lower the maximum interchange fee a large debit card issuer may charge
10/31/23	12 C.F.R. 1033	CFPB issues rulemaking proposal to implement §1033 of the Dodd–Frank Act
10/30/23	n/a	Agencies issue principles for climate-related financial risk management for large financial institutions
10/12/23	Reg. B	CFPB and Department of Justice issue Joint Statement on Fair Lending and Credit Opportunities for Noncitizen Borrowers Under the Equal Credit Opportunity Act
09/21/23	Reg. V	CFPB begins rulemaking process to regulate consumer reporting of medical debts

REGULATORY CALENDAR

EFFECTIVE DATE OR PROPOSAL DATE†	IMPLEMENTING REGULATION	REGULATORY CHANGE
09/19/23	Reg. B	CFPB issues Advisory Opinion on adverse action notice requirements for creditors using artificial intelligence
08/29/23	Reg. B	CFPB's Statement on Enforcement and Supervisory Practices Relating to the Small Business Lending Rule Under the Equal Credit Opportunity Act and Regulation B
07/21/23	FHA, Regs. Z and B	Proposed Interagency Guidance on Reconsiderations of Value of Residential Real Estate Valuations
07/06/23	Reg. B	CFPB issues annual fair lending report for 2022
06/21/23	Reg. Z	Agencies issue proposed rulemaking on quality control standards for automated valuation models
05/11/23	Reg. Z	CFPB issues proposed rule for residential property assessed clean energy financing
04/03/23	UDAAP	CFPB issues policy statement on prohibition of abusive acts or practices
**	Reg. B	CFPB's final rule under §1071 of the Dodd–Frank Act requiring lenders to collect small business loan data
03/29/23	Reg. Z	CFPB issues rulemaking proposal to revise safe-harbor credit card late fees

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

** On October 26, 2023, a federal district court in Texas temporarily suspended enforcement of the rule nationwide.

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2024 Calendar of Events

March 4–7, 2024	**2024 National Interagency Community Reinvestment Conference** Oregon Convention Center Portland, OR
March 15, 2024	**Consumer Research Symposium** FDIC Arlington, VA
April 18–19, 2024	**Inaugural Fintech and Financial Institutions Research Conference** Federal Reserve Bank of Philadelphia Philadelphia, PA
May 2–3, 2024	**2024 CFPB Research Conference** CFPB Washington, D.C.
May 15–16, 2024	**The Mortgage Market Research Conference** Federal Reserve Bank of Philadelphia Philadelphia, PA
June 11–14, 2024	**American Bankers Association Annual Risk and Compliance Conference** Seattle Convention Center Seattle, WA

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