Auditing
Real Estate Loans Boot Camp
Introduction, Learning, General Audit

Wisconsin Bankers Association

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Consultants to the Financial Industry
Young & Associates, Inc.
121 E. Main Street
P.O. Box 711
Kent, OH 44240
Phone: 330.678.0524
Fax: 330.678.6219
www.younginc.com

Bill Elliott, CRCM, Senior Consultant and Manager of Compliance

Bill Elliott has over 35 years of banking experience. As a compliance consultant and manager of the compliance division with Young & Associates, Inc., Bill works on a variety of compliance-related issues, including leading compliance seminars, conducting compliance reviews for all areas of compliance, conducting in-house training, and writing compliance articles and training materials. During his career, Bill spent 15 years as a compliance officer and CRA officer in a large community bank, and also worked for a large regional bank. He has been a lender for consumer, commercial, and mortgage loans, and has managed a variety of bank departments, including loan review, consumer/commercial loan processing, mortgage loan processing, loan administration, credit administration, collections, and commercial loan workout.

Aaron Lewis, Senior Consultant

Aaron Lewis has more than 15 years of experience in the banking industry. A majority of his time is dedicated to the lending division of Young & Associates, Inc., assisting client banks with loan reviews, ALLL reviews, policy reviews, and credit process reviews. Aaron also assists the compliance division by contributing to various regulatory compliance reviews. In addition to review work, Aaron conducts seminars covering various credit risk and compliance topics. Prior to joining Young & Associates, Inc. Aaron was the Vice President Credit Administrator of a community bank in southeast Michigan. During his time at the bank Aaron managed all facets of the lending function including originations, underwriting, ALLL analysis, servicing, and secondary market compliance. Aaron holds a B.A. in finance from Michigan State University and graduated from the Graduate School of Banking, University of Wisconsin.

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Preparing for the Audit

and

The Regulatory and Examination Environment

Section 1: Preparing for the Audit

Introduction

This manual has been designed to assist you in the audit of a closed-end consumer residential real estate loan. Open-end home equity lines of credit (HELOCs), credit cards, and other types of open-end credit are not covered by this manual, nor will we focus on other consumer-purpose loan types that do not involve residential real estate.

This manual is meant to be a guide through the loan documentation process and assumes a basic understanding of the governing regulations. We recommend a complete audit of the regulation if there is any question on a particular issue.

We have divided the presentation and the audit worksheets by regulatory requirement and have provided audit checklists for all areas, some of which may not be germane to each consumer residential real estate loan that you review.

The Audit Scope

There is no right or wrong way to identify your audit scope. The regulatory agencies do not generally prescribe a minimum number of loan files to be audited. In fact, as few as five loan files might be sufficient, depending upon your focus and a bank's corresponding loan population for a given audit period.

However, when making your determination regarding scope, we recommend that, at a minimum, you attempt to meet the following standards:

- Pick the category of loan to be audited, such as fixed-rate or adjustable-rate mortgages. You may wish to also subdivide these into loan purpose, such as purchase or refinance.
- Any audit is best if it covers:
  - All offices
  - All officers
  - All processors

The closer you can get to this level of coverage, the better. If you accomplish this, you will have the best understanding of any issues that may exist within the bank regarding the product under audit. If you use a judgmental system, covering all officers is especially important as you audit Regulation B (fair lending) issues, as lenders may view situations differently and, therefore, treat customers differently.

Each bank is unique. For instance, if all of your processing is done from a central location, covering all processors is probably accomplished more easily and is probably less necessary. The more decentralized your processors and your systems are; the more effort you will need to put into getting a cross-section of files for that particular loan type. With the advent of computerized lending systems, any systemic errors regarding your loan documentation system will become apparent in just a few files.

You may wish to discuss sample size with your internal or external auditor, as they may be able to provide insight into the process and suggest appropriate sample sizes for each audit.

Throughout this manual, “audit” and “review” are used interchangeably.

Discussion

1. How do you normally set up for this type of audit?
2. How do you choose your sample?
3. How often is the audit performed?
4. Is it internal or external?
5. If external, what kind of source are you using? Consultants, accountants, others?

Section 2: FDIC Examination Manual – Overview of Compliance Examinations (Abridged)

Introduction

The Federal Deposit Insurance Corporation (FDIC) promotes compliance with federal consumer protection laws, fair lending statutes and regulations, and the Community Reinvestment Act through supervisory and outreach programs. The FDIC conducts three types of supervisory activities to review an institution's compliance management system; compliance examinations, visitations, and investigations.

Compliance examinations are the primary means the FDIC uses to determine whether a financial institution is meeting its responsibility to comply with the requirements and proscriptions of federal consumer protection laws and regulations. The FDIC conducts visitations for a variety of reasons: to review the compliance posture of newly-chartered institutions or those converting to state non-member status; to review progress on corrective actions or compliance with an enforcement action in the interval between examinations; or to investigate problems brought to the attention of the FDIC. Visitations are usually targeted events aimed at specific operational areas, or entire compliance management systems previously identified as significantly deficient. Compliance examinations and visitations may also be considered during the review of an application submitted to the FDIC (e.g., application for deposit insurance or establishing a branch). Finally, investigations are conducted primarily to follow-up on particular consumer inquiries or complaints, including fair lending complaints.

This section provides a general overview of the FDIC compliance examination. The purposes of compliance examinations are to:

- assess the quality of an FDIC-supervised institution's compliance management system (see "Compliance Management System") for implementing federal consumer protection statutes and regulations;
- review compliance with relevant laws and regulations; and
- initiate effective supervisory action when elements of an institution's compliance management system are deficient and/or when violations of law are found.

Examination Approach

FDIC compliance examinations blend risk-focused and process-oriented approaches. Risk-focusing involves using information gathered about a financial institution to direct FDIC examiner resources to those operational areas where compliance errors present the greatest potential risks of having a negative impact on bank customers, resulting in consumer harm (See the Evaluating Impact of Consumer Harm section of this manual at page II-2.1 for additional information.) Concentrating on the institution's internal control infrastructure and methods, or the "process" used to ensure compliance with federal consumer protection laws and regulations, both acknowledges that the ultimate responsibility for compliance rests with the institution and encourages examination efficiency.

Determining Risk

Risk-focusing involves:

- developing a compliance risk profile for an institution using various sources of information about its products, services, markets , organizational structure, operations, and past supervisory performance;
- assessing the quality of an institution's compliance management system in light of the inherent risks associated with the level and complexity of its business operations and product and service offerings; and
- testing selected transactions based on risk such as when an operational area is determined to have a high risk of consumer harm and institution's compliance management efforts appear weak.

Evaluating the Compliance Management System

Compliance examinations start with a top-down, risk-focused process to comprehensively analyze and review an institution's compliance management system. The compliance examiner considers:

Board and Management Oversight

- Commitment to and oversight of the institution's CMS.
- Level of resources dedicated toward compliance functions.
- Due diligence and oversight of third parties to ensure compliance with consumer protection laws and regulations, and appropriate oversight of third parties' compliance responsibilities.
- Anticipation and responsiveness to changes in applicable laws and regulations, market conditions, and products and services offered.
- Due diligence reviews performed in advance of product changes, considering the entire lifecyle of the product or service, and after implementation of changes.
- Comprehension and identification of compliance risks, including emerging risks, in the institution's financial products, services, and other activities.
- Management of identified risk, including self-assessments.
- Identification of and responsiveness to compliance risk management deficiencies and violations of law or regulations, including remediation.

Compliance Program

- Whether the institution's policies and procedures are appropriate to the risk in the products, services, and activities of the institution.
- Adequacy of third-party relationship program management.
- The degree to which compliance training is current and tailored to risk and staff responsibilities.
- The sufficiency of the monitoring and, if applicable, audit to encompass compliance risks throughout the institution
- The responsiveness and effectiveness of the consumer complaint resolution process.

Based on the results of this review, the examiner may conclude that weaknesses in the institution's compliance management system may result in current or future noncompliance with federal consumer protection laws, regulations, or policy statements, thereby resulting in potential consumer harm. The examiner must determine, based on this analysis, whether transaction testing is warranted to further study particular risk in an entire operational area or regulation, or only a limited aspect of an area or regulation.

The FDIC examination approach appropriately recognizes that the Board of Directors and management of a financial institution are responsible for complying with all federal consumer protection laws and regulations. While the formality and complexity of compliance management systems will vary greatly among institutions, the FDIC expects the Board of Directors and management of each institution to have a system in place to effectively manage its compliance risk, consistent with the size and complexity of its products, services, and markets.

Managing the examination based on risk maximizes examiner efficiency and may reduce the on-site examination presence, while emphasizing areas requiring elevated supervisory attention. By focusing on compliance management systems, examiners will be able to identify the root causes of deficiencies and suggest appropriate corrective actions designed to address the problem and prevent recurrence.

Applicability and Adaptability to Large and Small Institutions

In order to provide as much relevant and useful guidance as possible, the procedures detailed in this Manual include instructions for reviewing the various elements of a compliance management system (CMS), such as written policies and procedures, monitoring and/or audit, and training. When these elements are in place at an institution being examined, the examiner will use the guidance to evaluate their effectiveness. However, the fact that certain elements of a CMS are described in these examination procedures is not intended to suggest that all institutions *must* maintain a CMS that includes all of these elements. Many institutions do not. There is no reason for them to, if their operations do not warrant it. Conclusions about the adequacy of a bank's CMS must be based on the effectiveness of those elements that are in place, taken as a whole, for that bank's particular operations.

For example, assume two institutions – a large, complex bank and a small, non-complex bank – each has a record of strong compliance with all regulations that apply to the products and services it offers. Because of the complex nature of its operations, the large bank's CMS includes comprehensive external audits and formalized training from third-party vendors. The smaller bank's CMS includes no internal or external audits and no formalized training except for the compliance officer, who trains bank staff individually when needed. After reviewing all relevant material available, the examiner finds no significant deficiencies in the small bank's CMS and no reason to believe that the adoption of an audit function or formalized training is necessary to ensure ongoing compliance. The examiner would not criticize the small bank for the absence of audit (or formal training.) Nor should the examiner feel obliged to assign a higher rating to the larger bank simply because its CMS has more elements than the smaller bank. This is because each bank has a CMS that is adequate for the compliance responsibilities that are incumbent upon it due to its operating environment.

The descriptions of CMS elements provided in the Manual will assist the examiner in evaluating the element if one exists and in suggesting content if he or she determines that management should consider adopting an element.

Overview of the Examination Process

Compliance examinations primarily involve three stages: pre- examination planning; review and analysis, both off-site and on-site; and communicating findings to institution management via meetings and a report of examination.

Pre-examination Planning

Pre-examination planning involves gathering information available in FDIC records and databases, contacting the financial institution to review and narrow the draft request for information and documents, and delivering a letter to the institution requesting specific information and documents for detailed analysis by the examination team (*see* Section III). Proper examination preparation and planning maximizes an examination team's time and resources.

Review and Analysis

During the review and analysis phase of an examination, an examiner thoroughly evaluates an institution's compliance management system to assess its quality and effectiveness, and documents system weaknesses and violations of federal consumer protection laws and regulations, if any. The EIC starts by analyzing information about the type, level, and complexity of the institution's operations, and begins to develop the scope of the examination and plan for resource deployment to areas of highest risk. The EIC also preliminarily assesses the potential risk of consumer harm based upon the information available at the time of pre-examination planning.

The scope of an examination will be preliminarily established prior to entering the financial institution, and should be refined through the results of examiner discussions with management, the compliance officer (or staff assigned), and the internal auditor. Consistent with the FDIC's approach, examination resources are focused on addressing the areas of highest consumer harm risk. Additionally, there may be some cases where the EIC may include additional areas in the examination scope even though consumer harm risk is not exhibited. While on-site at an institution, an examiner may limit the scope of the compliance review based on reliable procedures and controls in place. Similarly, the examiner may expand the review based on, for example, management's view about compliance, a lack of necessary procedures or controls, the presence of violations, the identification of potential or actual consumer harm, or the presence of new or significantly amended regulations. The compliance review continues with an evaluation of the:

- commitment of the Board of Directors, management, and staff to compliance;
- qualifications of the compliance officer or designated staff;
- scope and effectiveness of compliance policies and procedures;
- effectiveness of training;
- thoroughness of monitoring and any internal/external reviews or audits; and
- responsiveness of the Board and management to the findings of internal/external reviews and to the findings of the previous examination.

An examiner must consider the size, level, and complexity of an institution's operations when evaluating the adequacy of an institution's compliance management system.

Knowledge Preparation

Regulation Z

Section 1: Authority, Purpose, Coverage, Organization, Enforcement and Liability

12 C.F.R. § 1026.1

Authority - 12 CFR § 1026.1(a)

Regulatory Discussion

There is nothing relevant to our discussion in this section.

Purpose - 12 CFR § 1026.1(b)

Regulatory Discussion

Truth in Lending (TIL) is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. It gives consumers the right to cancel certain credit transactions that involve a lien on a consumer's principal dwelling, as well as a variety of other rights. It creates a format in which all financial institutions use the same disclosure methods.

The regulation also imposes limitations on home-equity plans and certain closed-end home mortgages, prohibits certain acts or practices in connection with credit secured by a dwelling and credit secured by a consumer's principal dwelling. There are also specific requirements for creditors who extend private education loans.

The regulation does not govern charges for consumer credit. However, the regulation requires a maximum interest rate to be stated in variable rate contracts secured by the consumer's dwelling, and special rules addressing certain charges applicable to credit card accounts under an open-end (not home-secured) consumer credit plan.

It is important to understand that the results of some of the methods used to complete disclosures create "mythical" numbers. However, because Regulation Z requires uniform disclosure methods and calculations, the applicant and/or borrower is in a position to compare different loan offers from a variety of financial institutions.

Regulatory Text

(b) **Purpose.** The purpose of this part is to promote the informed use of consumer credit by requiring disclosures about its terms and cost, to ensure that consumers are provided with greater and more timely information on the nature and costs of the residential real estate settlement process, and to effect certain changes in the settlement process for residential real estate that will result in more effective advance disclosure to home buyers and sellers of settlement costs. The regulation also includes substantive protections. It gives consumers the right to cancel certain credit transactions that involve a lien on a consumer's principal dwelling, regulates certain credit card practices, and provides a means for fair and timely resolution of credit billing disputes. The regulation does not generally govern charges for consumer credit, except that several provisions in subpart G set forth special rules addressing certain charges applicable to credit card accounts under an open-end (not home-secured) consumer credit plan. The regulation requires a maximum interest rate to be stated in variable-rate contracts secured by the consumer's dwelling. It also imposes limitations on home-equity plans that are subject to the requirements of §1026.40 and mortgages that are subject to the requirements of §1026.32. The regulation prohibits certain acts or practices in connection with credit secured by a dwelling in §1026.36, and credit secured by a consumer's principal dwelling in §1026.35. The regulation also regulates certain practices of creditors who extend private education loans as defined in §1026.46(b)(5). In addition, it imposes certain limitations on increases in costs for mortgage transactions subject to §1026.19(e) and (f).

Regulatory Commentary

None.

Coverage - 12 CFR § 1026.1(c)

Regulatory Discussion

At its simplest, TIL coverage is based on whether or not the loan is a consumer loan. Specifically, TIL disclosures must be made if the bank:

- Extends credit to consumers;
- Offers or extends credit regularly;
- Charges finance charges or credit is repayable by written agreement in four or more installments; and
- Extends the credit primarily for personal, family, or household purposes
- Exempt transactions are more fully described in the following section.

Regulatory Text

(c) **Coverage.**

(1) In general, this part applies to each individual or business that offers or extends credit, other than a person excluded from coverage of this part by section 1029 of the Consumer Financial Protection Act of 2010, title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376, when four conditions are met:

(i) The credit is offered or extended to consumers;

(ii) The offering or extension of credit is done regularly;

(iii) The credit is subject to a finance charge or is payable by a written agreement in more than four installments; and

(iv) The credit is primarily for personal, family, or household purposes.

(2) If a credit card is involved, however, certain provisions apply even if the credit is not subject to a finance charge, or is not payable by a written agreement in more than four installments, or if the credit card is to be used for business purposes.

(3) In addition, certain requirements of §1026.40 apply to persons who are not creditors but who provide applications for home-equity plans to consumers.

(4) Furthermore, certain requirements of §1026.57 apply to institutions of higher education.

(5) Except in transactions subject to §1026.19(e) and (f), no person is required to provide the disclosures required by sections 128(a)(16) through (19), 128(b)(4), 129C(f)(1), 129C(g)(2) and (3), 129D(h), or 129D(j)(1)(A) of the Truth in Lending Act, section 4(c) of the Real Estate Settlement Procedures Act, or the disclosure required prior to settlement by section 129C(h) of the Truth in Lending Act. Except in transactions subject to §1026.20(e), no person is required to provide the disclosure required by section 129D(j)(1)(B) of the Truth in Lending Act. Except in transactions subject to §1026.39(d)(5), no person becoming a creditor with respect to an existing residential mortgage loan is required to provide the disclosure required by section 129C(h) of the Truth in Lending Act.

Regulatory Commentary

1(c) Coverage

*1. **Foreign applicability.** [Omitted, as nothing here is relevant.]*

Paragraph 1(c)(5).

*1. **Exemption for certain mortgage transactions.** Section 1026.1(c)(5) implements sections 128(a)(16) through (19), 128(b)(4), 129C(f)(1), 129C(g)(2) and (3), 129C(h), 129D(h), 129D(j)(1)(A), and 129D(j)(1)(B) of the Truth in Lending Act and section 4(c) of the Real Estate Settlement Procedures Act, by exempting persons from the disclosure requirements of those sections, except in certain transactions. The exemptions do not apply to certain transactions for which the disclosure requirements are implemented in other parts of Regulation Z. Sections 1026.37 and 1026.38 implement sections 128(a)(16) through (19), 128(b)(4), 129C(f)(1), 129C(g)(2) and (3), 129D(h), and 129D(j)(1)(A) of the Truth in Lending Act and section 4(c) of the Real Estate Settlement Procedures Act for transactions subject to §1026.19(e) and (f). Section 1026.38(l)(5) implements the disclosure requirements of section 129C(h) of the Truth in Lending Act for transactions subject to §1026.19(f). Section 1026.39(d)(5) implements the disclosure requirements of section 129C(h) of the Truth in Lending Act for transactions subject to §1026.39(d)(5). Section 1026.20(e) implements the disclosure requirements of section 129D(j)(1)(B) of the*

Truth in Lending Act for transactions subject to §1026.20(e). Section 1026.1(c)(5) does not exempt any person from any other requirement of this part, Regulation X (12 CFR part 1024), the Truth in Lending Act, or the Real Estate Settlement Procedures Act.

Organization - 12 CFR § 1026.1(d)

Regulatory Discussion

There is nothing relevant to our discussion in this section.

Enforcement - 12 CFR § 1026.1(e)

Regulatory Discussion

There is nothing relevant to our discussion in this section.

Section 2: Exempt Transactions
12 C.F.R § 1026.3(a)

Exempt Transactions (General) - 12 C.F.R § 1026.3

Regulatory Discussion

Regulation Z exempts certain transactions from coverage, which are covered in this section. There is also a dollar threshold for certain types of credit, which is adjusted annually.

Regulatory Text (Introduction)

The following transactions are not subject to this part or, if the exemption is limited to specified provisions of this part, are not subject to those provisions:

Regulatory Commentary

Section 1026.3 - Exempt Transactions

1. ***Relationship to §1026.12.*** *The provisions in §1026.12(a) and (b) governing the issuance of credit cards and the limitations on liability for their unauthorized use apply to all credit cards, even if the credit cards are issued for use in connection with extensions of credit that otherwise are exempt under this section.*

Business, Commercial, Agricultural, or Organizational Credit - 12 CFR § 1026.3(a)

Regulatory Discussion

This section describes the exemptions for:

- Business or commercial, including specific examples for non-owner-occupied and owner-occupied rental property;
- Agricultural; or
- Organizational, including credit extended to trusts.

Regulatory Text

(a) **Business, commercial, agricultural, or organizational credit.**

(1) An extension of credit primarily for a business, commercial or agricultural purpose.

(2) An extension of credit to other than a natural person, including credit to government agencies or instrumentalities.

Regulatory Commentary

3(a) Business, Commercial, Agricultural, or Organizational Credit

*1. **Primary purposes.** A creditor must determine in each case if the transaction is primarily for an exempt purpose. If some question exists as to the primary purpose for a credit extension, the creditor is, of course, free to make the disclosures, and the fact that disclosures are made under such circumstances is not controlling on the question of whether the transaction was exempt. (See comment 3(a)-2, however, with respect to credit cards.)*

*2. **Business purpose purchases.***

i. Business-purpose credit cards - extensions of credit for consumer purposes. If a business-purpose credit card is issued to a person, the provisions of the regulation do not apply, other than as provided in §§1026.12(a) and 1026.12(b), even if extensions of credit for consumer purposes are occasionally made using that business-purpose credit card. For example, the billing error provisions set forth in §1026.13 do not apply to consumer-purpose extensions of credit using a business-purpose credit card.

ii. Consumer-purpose credit cards - extensions of credit for business purposes. If a consumer-purpose credit card is issued to a person, the provisions of the regulation apply, even to occasional extensions of credit for business purposes made using that consumer-purpose credit card. For example, a consumer may assert a billing error with respect to any extension of credit using a consumer-purpose credit card, even if the specific extension of credit on such credit card or open-end credit plan that is the subject of the dispute was made for business purposes.

*3. **Factors.** In determining whether credit to finance an acquisition—such as securities, antiques, or art—is primarily for business or commercial purposes (as opposed to a consumer purpose), the following factors should be considered:*

*i. **General.***

A. The relationship of the borrower's primary occupation to the acquisition. The more closely related, the more likely it is to be business purpose.

B. The degree to which the borrower will personally manage the acquisition. The more personal involvement there is, the more likely it is to be business purpose.

C. The ratio of income from the acquisition to the total income of the borrower. The higher the ratio, the more likely it is to be business purpose.

D. The size of the transaction. The larger the transaction, the more likely it is to be business purpose.

E. The borrower's statement of purpose for the loan.

*ii. **Business-purpose examples.** Examples of business-purpose credit include:*

A. A loan to expand a business, even if it is secured by the borrower's residence or personal property.

B. A loan to improve a principal residence by putting in a business office.

C. A business account used occasionally for consumer purposes.

*iii. **Consumer-purpose examples.** Examples of consumer-purpose credit include:*

A. Credit extensions by a company to its employees or agents if the loans are used for personal purposes.

B. A loan secured by a mechanic's tools to pay a child's tuition.

C. A personal account used occasionally for business purposes.

*4. **Non-owner-occupied rental property.** Credit extended to acquire, improve, or maintain rental property (regardless of the number of housing units) that is not owner-occupied is deemed to be for business purposes. This includes, for example, the acquisition of a warehouse that will be leased or a single-family house that will be rented to another person to live in. If the owner expects to occupy the property for more than 14 days during the coming year, the property cannot be considered non-owner-occupied and this special rule will not apply. For example, a beach house that the owner will occupy for a month in the coming summer and rent out the rest of the year is owner occupied and is not governed by this special rule. (See comment 3(a)-5, however, for rules relating to owner-occupied rental property.)*

*5. **Owner-occupied rental property.** If credit is extended to acquire, improve, or maintain rental property that is or will be owner-occupied within the coming year, different rules apply:*

i. Credit extended to acquire the rental property is deemed to be for business purposes if it contains more than 2 housing units.

ii. Credit extended to improve or maintain the rental property is deemed to be for business purposes if it contains more than 4 housing units. Since the amended statute defines dwelling to include 1 to 4 housing units, this rule preserves the right of rescission for credit extended for purposes other than acquisition. Neither of these rules means that an extension of credit for property containing fewer than the requisite number of units is necessarily consumer credit. In such cases, the determination of whether it is business or consumer credit should be made by considering the factors listed in comment 3(a)-3.

*6. **Business credit later refinanced.** Business-purpose credit that is exempt from the regulation may later be rewritten for consumer purposes. Such a transaction is consumer credit requiring disclosures only if the existing obligation is satisfied and replaced by a new obligation made for consumer purposes undertaken by the same obligor.*

*7. **Credit card renewal.** A consumer-purpose credit card that is subject to the regulation may be converted into a business-purpose credit card at the time of its renewal, and the resulting business-purpose credit card would be exempt from the regulation. Conversely,* *a business-purpose credit card that is exempt from the regulation may be converted into a consumer-purpose credit card at the time of its renewal, and the resulting consumer-purpose credit card would be subject to the regulation.*

8. ***Agricultural purpose.*** *An agricultural purpose includes the planting, propagating, nurturing, harvesting, catching, storing, exhibiting, marketing, transporting, processing, or manufacturing of food, beverages (including alcoholic beverages), flowers, trees, livestock, poultry, bees, wildlife, fish, or shellfish by a natural person engaged in farming, fishing, or growing crops, flowers, trees, livestock, poultry, bees, or wildlife. The exemption also applies to a transaction involving real property that includes a dwelling (for example, the purchase of a farm with a homestead) if the transaction is primarily for agricultural purposes.*

9. ***Organizational credit.*** *The exemption for transactions in which the borrower is not a natural person applies, for example, to loans to corporations, partnerships, associations, churches, unions, and fraternal organizations. The exemption applies regardless of the purpose of the credit extension and regardless of the fact that a natural person may guarantee or provide security for the credit. But see comment 3(a)-10 concerning credit extended to trusts.*

10. ***Trusts.*** *Credit extended for consumer purposes to certain trusts is considered to be credit extended to a natural person rather than credit extended to an organization. Specifically:*

    i. ***Trusts for tax or estate planning purposes.*** *In some instances, a creditor may extend credit for consumer purposes to a trust that a consumer has created for tax or estate planning purposes (or both). Consumers sometimes place their assets in trust, with themselves or themselves and their families or other prospective heirs as beneficiaries, to obtain certain tax benefits and to facilitate the future administration of their estates. During their lifetimes, however, such consumers may continue to use the assets and/or income of such trusts as their property. A creditor extending credit to finance the acquisition of, for example, a consumer's dwelling that is held in such a trust, or to refinance existing debt secured by such a dwelling, may prepare the note, security instrument, and similar loan documents for execution by a trustee, rather than the beneficiaries of the trust. Regardless of the capacity or capacities in which the loan documents are executed, assuming the transaction is primarily for personal, family, or household purposes, the transaction is subject to the regulation because in substance (if not form) consumer credit is being extended.*

    ii. ***Land trusts.*** *In some jurisdictions, a financial institution financing a residential real estate transaction for an individual uses a land trust mechanism. Title to the property is conveyed to the land trust for which the financial institution itself is trustee. The underlying installment note is executed by the financial institution in its capacity as trustee and payment is secured by a trust deed, reflecting title in the financial institution as trustee. In some instances, the consumer executes a personal guaranty of the indebtedness. The note provides that it is payable only out of the property specifically described in the trust deed and that the trustee has no personal liability on the note. Assuming the transactions are primarily for personal, family, or household purposes, these transactions are subject to the regulation because in substance (if not form) consumer credit is being extended.*

Knowledge Preparation

Regulation X

Section 1: Coverage [12 C.F.R. § 1024.5]

Coverage [12 CFR § 1024.5]

Regulatory Discussion

The Real Estate Settlement Procedures Act applies to all federally related mortgage loans. Generally, this means that if an institution is insured by federal deposit insurance and the loan is secured by a one- to four-family residential property, then RESPA applies.

Exemptions

The following loans are exempt from the RESPA disclosure requirements:

- ***Business purpose loans as defined by Regulation Z.***
  - ***Need to review Regulation Z requirements to fully understand these implications.***
- ***Temporary financing***
  - ***Construction loans (1-4 family) not covered.***
  - ***If the construction loan is used as, or*** may be converted to permanent financing by the same lender, a lender cannot use this exception.
  - If the lender issues a commitment for the end financing, the lender cannot use this exception. Conditions do not matter.
  - If the loan is used to finance transfer of title to the first user, the lender cannot use this exception.
  - A construction loan for new or rehabilitated 1-4 family residential property, other than a loan to a *bona fide* builder, cannot exceed 2 years, or it is subject to this regulation.
  - A "bridge loan" or "swing loan" in which a lender takes a security interest a 1-4 family residential property is not covered by RESPA.
- ***Vacant land, unless some of the loan proceeds will be used to place a structure on the property within 2 years from the settlement date.***
- ***Assumption without lender approval.***
- ***Loan conversions.***
- ***Secondary market transactions.***

Relation to State Laws

This portion of the regulation has a section devoted to this issue. However, for most states, this portion has no impact.

Regulatory Text – Coverage of RESPA [12 CFR § 1024.5]

(a) **Applicability**. RESPA and this part apply to all federally related mortgage loans, except for the exemptions provided in paragraph (b) of this section.

(b) **Exemptions.**

(1) [Reserved.]

(2) **Business purpose loans.** An extension of credit primarily for a business, commercial, or agricultural purpose, as defined by 12 CFR 1026.3(a)(1) of Regulation Z. Persons may rely on Regulation Z in determining whether the exemption applies.

(3) **Temporary financing.** Temporary financing, such as a construction loan. The exemption for temporary financing does not apply to a loan made to finance construction of 1- to 4-family residential property if the loan is used as, or may be converted to, permanent financing by the same lender or is used to finance transfer of title to the first user. If a lender issues a commitment for permanent financing, with or without conditions, the loan is covered by this part. Any construction loan for new or rehabilitated 1- to 4-family residential property, other than a loan to a bona fide builder (a person who regularly constructs 1- to 4-family residential structures for sale or lease), is subject to this part if its term is for two years or more. A "bridge loan" or "swing loan" in which a lender takes a security interest in otherwise covered 1- to 4-family residential property is not covered by RESPA and this part.

(4) **Vacant land.** Any loan secured by vacant or unimproved property, unless within two years from the date of the settlement of the loan, a structure or a manufactured home will be constructed or placed on the real property using the loan proceeds. If a loan for a structure or manufactured home to be placed on vacant or unimproved property will be secured by a lien on that property, the transaction is covered by this part.

(5) **Assumption without lender approval.** Any assumption in which the lender does not have the right expressly to approve a subsequent person as the borrower on an existing federally related mortgage loan. Any assumption in which the lender's permission is both required and obtained is covered by RESPA and this part, whether or not the lender charges a fee for the assumption.

(6) **Loan conversions.** Any conversion of a federally related mortgage loan to different terms that are consistent with provisions of the original mortgage instrument, as long as a new note is not required, even if the lender charges an additional fee for the conversion.

(7) **Secondary market transactions.** A bona fide transfer of a loan obligation in the secondary market is not covered by RESPA and this part, except with respect to RESPA (12 U.S.C. 2605) and subpart C of this part (§§1024.30-1024.41). In determining what constitutes a bona fide transfer, the Bureau will consider the real source of funding and the real interest of the funding lender. Mortgage broker transactions that are table-funded are not secondary market transactions. Neither the creation of a dealer loan or

dealer consumer credit contract, nor the first assignment of such loan or contract to a lender, is a secondary market transaction (see §1024.2).

(c) **Relation to State laws.**

(1) State laws that are inconsistent with RESPA or this part are preempted to the extent of the inconsistency. However, RESPA and these regulations do not annul, alter, affect, or exempt any person subject to their provisions from complying with the laws of any State with respect to settlement practices, except to the extent of the inconsistency.

(2) Upon request by any person, the Bureau is authorized to determine if inconsistencies with State law exist; in doing so, the Bureau shall consult with appropriate Federal agencies.

(i) The Bureau may not determine that a State law or regulation is inconsistent with any provision of RESPA or this part, if the Bureau determines that such law or regulation gives greater protection to the consumer.

(ii) In determining whether provisions of State law or regulations concerning affiliated business arrangements are inconsistent with RESPA or this part, the Bureau may not construe those provisions that impose more stringent limitations on affiliated business arrangements as inconsistent with RESPA so long as they give more protection to consumers and/or competition.

(3) Any person may request the Bureau to determine whether an inconsistency exists by submitting to the address established by the Bureau to request an official interpretation, a copy of the State law in question, any other law or judicial or administrative opinion that implements, interprets or applies the relevant provision, and an explanation of the possible inconsistency. A determination by the Bureau that an inconsistency with State law exists will be made by publication of a notice in the FEDERAL REGISTER. "Law" as used in this section includes regulations and any enactment which has the force and effect of law and is issued by a State or any political subdivision of a State.

(4) A specific preemption of conflicting State laws regarding notices and disclosures of mortgage servicing transfers is set forth in §1024.33(d).

d) **Partial exemptions for certain mortgage loans.** Sections 1024.6, 1024.7, 1024.8, 1024.10, and 1024.33(a) do not apply to a federally related mortgage loan:

(1) That is subject to the special disclosure requirements for certain consumer credit transactions secured by real property set forth in Regulation Z, 12 CFR 1026.19(e), (f), and (g); or

(2) That satisfies the criteria in Regulation Z, 12 CFR 1026.3(h).

Regulatory Commentary – Coverage of RESPA [12 CFR § 1024.5]

5(c) Relation to State laws.

Paragraph 5(c)(1).

(1) State laws that are inconsistent with the requirements of RESPA or Regulation X may be preempted by RESPA or Regulation X. State laws that give greater protection to consumers

are not inconsistent with and are not preempted by RESPA or Regulation X. In addition, nothing in RESPA or Regulation X should be construed to preempt the entire field of regulation of the practices covered by RESPA or Regulation X, including the regulations in Subpart C with respect to mortgage servicers or mortgage servicing.

Knowledge Preparation

Regulation Z: Finance Charges

Section 1: Definition and Third-Party Charges
12 C.F.R. § 1026.4(a)

Basic Definition - 12 CFR § 1026.4(a)

Regulatory Discussion

The finance charge is often a confusing term. This section provides the regulatory definition as well as commentary providing examples of items which are not finance charges and items which are finance charges. The regulation offers a basic definition. The commentary discusses charges in comparable cash transactions, forfeitures of interest. costs of doing business, treatment of transaction fees on credit card plans, and taxes.

Regulatory Text

(a) **Definition.** The finance charge is the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. It does not include any charge of a type payable in a comparable cash transaction.

Regulatory Commentary

4(a) Definition

1. ***Charges in comparable cash transactions.*** *Charges imposed uniformly in cash and credit transactions are not finance charges. In determining whether an item is a finance charge, the creditor should compare the credit transaction in question with a similar cash transaction. A creditor financing the sale of property or services may compare charges with those payable in a similar cash transaction by the seller of the property or service.*

   i. For example, the following items are not finance charges:

      A. Taxes, license fees, or registration fees paid by both cash and credit customers.

      B. Discounts that are available to cash and credit customers, such as quantity discounts.

      C. Discounts available to a particular group of consumers because they meet certain criteria, such as being members of an organization or having accounts at a particular financial institution. This is the case even if an individual must pay cash to obtain the discount, provided that credit customers who are members of the group and do not qualify for the discount pay no more than the nonmember cash customers.

D. Charges for a service policy, auto club membership, or policy of insurance against latent defects offered to or required of both cash and credit customers for the same price.

ii. In contrast, the following items are finance charges:

A. Inspection and handling fees for the staged disbursement of construction-loan proceeds.

B. Fees for preparing a Truth in Lending disclosure statement, if permitted by law (for example, the Real Estate Settlement Procedures Act prohibits such charges in certain transactions secured by real property).

C. Charges for a required maintenance or service contract imposed only in a credit transaction.

iii. If the charge in a credit transaction exceeds the charge imposed in a comparable cash transaction, only the difference is a finance charge. For example:

A. If an escrow agent is used in both cash and credit sales of real estate and the agent's charge is $100 in a cash transaction and $150 in a credit transaction, only $50 is a finance charge.

2. ***Costs of doing business.*** *Charges absorbed by the creditor as a cost of doing business are not finance charges, even though the creditor may take such costs into consideration in determining the interest rate to be charged or the cash price of the property or service sold. However, if the creditor separately imposes a charge on the consumer to cover certain costs, the charge is a finance charge if it otherwise meets the definition. For example:*

   i. A discount imposed on a credit obligation when it is assigned by a seller-creditor to another party is not a finance charge as long as the discount is not separately imposed on the consumer. (See §1026.4(b)(6).)

   ii. A tax imposed by a state or other governmental body on a creditor is not a finance charge if the creditor absorbs the tax as a cost of doing business and does not separately impose the tax on the consumer. (For additional discussion of the treatment of taxes, see other commentary to §1026.4(a).)

3. ***Forfeitures of interest.*** *If the creditor reduces the interest rate it pays or stops paying interest on the consumer's deposit account or any portion of it for the term of a credit transaction (including, for example, an overdraft on a checking account or a loan secured by a certificate of deposit), the interest lost is a finance charge. (See the commentary to §1026.4(c)(6).) For example:*

   i. A consumer borrows $5,000 for 90 days and secures it with a $10,000 certificate of deposit paying 15% interest. The creditor charges the consumer an interest rate of 6% on the loan and stops paying interest on $5,000 of the $10,000 certificate for the term of the loan. The interest lost is a finance charge and must be reflected in the annual percentage rate on the loan.

ii. However, the consumer must be entitled to the interest that is not paid in order for the lost interest to be a finance charge. For example:

A. A consumer wishes to buy from a financial institution a $10,000 certificate of deposit paying 15% interest but has only $4,000. The financial institution offers to lend the consumer $6,000 at an interest rate of 6% but will pay the 15% interest only on the amount of the consumer's deposit, $4,000. The creditor's failure to pay interest on the $6,000 does not result in an additional finance charge on the extension of credit, provided the consumer is entitled by the deposit agreement with the financial institution to interest only on the amount of the consumer's deposit.

B. A consumer enters into a combined time deposit/credit agreement with a financial institution that establishes a time deposit account and an open-end line of credit. The line of credit may be used to borrow against the funds in the time deposit. The agreement provides for an interest rate on any credit extension of, for example, 1%. In addition, the agreement states that the creditor will pay 0% interest on the amount of the time deposit that corresponds to the amount of the credit extension(s). The interest that is not paid on the time deposit by the financial institution is not a finance charge (and therefore does not affect the annual percentage rate computation).

4. ***Treatment of transaction fees on credit card plans.*** *Except with regard to a covered separate credit feature and an asset feature on a prepaid account that are both accessible by a hybrid prepaid-credit card as defined in §1026.61, which are addressed in more detail in §§1026.4(b)(11) and 1026.61, any transaction charge imposed on a cardholder by a card issuer is a finance charge, regardless of whether the issuer imposes the same, greater, or lesser charge on withdrawals of funds from an asset account such as a checking or savings account. For example:*

i. Any charge imposed on a credit cardholder by a card issuer for the use of an automated teller machine (ATM) to obtain a cash advance (whether in a proprietary, shared, interchange, or other system) is a finance charge regardless of whether the card issuer imposes a charge on its debit cardholders for using the ATM to withdraw cash from a consumer asset account, such as a checking or savings account.

ii. Any charge imposed on a credit cardholder for making a purchase or obtaining a cash advance outside the United States, with a foreign merchant, or in a foreign currency is a finance charge, regardless of whether a charge is imposed on debit cardholders for such transactions. The following principles apply in determining what is a foreign transaction fee and the amount of the fee:

A. Included are (1) fees imposed when transactions are made in a foreign currency and converted to U.S. dollars; (2) fees imposed when transactions are made in U.S. dollars outside the U.S.; and (3) fees imposed when transactions are made (whether in a foreign currency or in U.S. dollars) with a foreign merchant, such as via a merchant's Web site. For example, a consumer may use a credit card to make a purchase in Bermuda, in U.S. dollars, and the card issuer may impose a fee because the transaction took place outside the United States.

B. Included are fees imposed by the card issuer and fees imposed by a third party that performs the conversion, such as a credit card network or the card issuer's corporate parent. (For example, in a transaction processed through a credit card network, the network may impose a 1 percent charge and the card-issuing bank may impose an additional 2 percent charge, for a total of a 3 percentage point foreign transaction fee being imposed on the consumer.)

C. Fees imposed by a third party are included only if they are directly passed on to the consumer. For example, if a credit card network imposes a 1 percent fee on the card issuer, but the card issuer absorbs the fee as a cost of doing business (and only passes it on to consumers in the general sense that the interest and fees are imposed on all its customers to recover its costs), then the fee is not a foreign transaction fee and need not be disclosed. In another example, if the credit card network imposes a 1 percent fee for a foreign transaction on the card issuer, and the card issuer imposes this same fee on the consumer who engaged in the foreign transaction, then the fee is a foreign transaction fee and a finance charge.

D. A card issuer is not required to disclose a fee imposed by a merchant. For example, if the merchant itself performs the currency conversion and adds a fee, this fee need not be disclosed by the card issuer. Under §1026.9(d), a card issuer is not obligated to disclose finance charges imposed by a party honoring a credit card, such as a merchant, although the merchant is required to disclose such a finance charge if the merchant is subject to the Truth in Lending Act and Regulation Z.

E. The foreign transaction fee is determined by first calculating the dollar amount of the transaction by using a currency conversion rate outside the card issuer's and third party's control. Any amount in excess of that dollar amount is a foreign transaction fee. Conversion rates outside the card issuer's and third party's control include, for example, a rate selected from the range of rates available in the wholesale currency exchange markets, an average of the highest and lowest rates available in such markets, or a government-mandated or government-managed exchange rate (or a rate selected from a range of such rates).

F. The rate used for a particular transaction need not be the same rate that the card issuer (or third party) itself obtains in its currency conversion operations. In addition, the rate used for a particular transaction need not be the rate in effect on the date of the transaction (purchase or cash advance).

*5. **Taxes.***

i. Generally, a tax imposed by a state or other governmental body solely on a creditor is a finance charge if the creditor separately imposes the charge on the consumer.

ii. In contrast, a tax is not a finance charge (even if it is collected by the creditor) if applicable law imposes the tax:

A. Solely on the consumer;

B. On the creditor and the consumer jointly;

C. On the credit transaction, without indicating which party is liable for the tax; or

D. On the creditor, if applicable law directs or authorizes the creditor to pass the tax on to the consumer. (For purposes of this section, if applicable law is silent as to passing on the tax, the law is deemed not to authorize passing it on.)

iii. For example, a stamp tax, property tax, intangible tax, or any other state or local tax imposed on the consumer, or on the credit transaction, is not a finance charge even if the tax is collected by the creditor.

iv. In addition, a tax is not a finance charge if it is excluded from the finance charge by another provision of the regulation or commentary (for example, if the tax is imposed uniformly in cash and credit transactions).

Charges by Third Parties - 12 CFR § 1026.4(a)(1) through 12 CFR § 1026.4(a)(3)

Regulatory Discussion

This section further describes third party charges that <u>may</u> or <u>may not</u> be a finance charge and includes special rules for closing agents and mortgage broker fees.

Regulatory Text

(1) **Charges by third parties.** The finance charge includes fees and amounts charged by someone other than the creditor, unless otherwise excluded under this section, if the creditor:

(i) Requires the use of a third party as a condition of or an incident to the extension of credit, even if the consumer can choose the third party; or

(ii) Retains a portion of the third-party charge, to the extent of the portion retained.

(2) **Special rule; closing agent charges.** Fees charged by a third party that conducts the loan closing (such as a settlement agent, attorney, or escrow or title company) are finance charges only if the creditor:

(i) Requires the particular services for which the consumer is charged;

(ii) Requires the imposition of the charge; or

(iii) Retains a portion of the third-party charge, to the extent of the portion retained.

(3) **Special rule; mortgage broker fees.** Fees charged by a mortgage broker (including fees paid by the consumer directly to the broker or to the creditor for delivery to the broker) are finance charges even if the creditor does not require the consumer to use a mortgage broker and even if the creditor does not retain any portion of the charge.

Regulatory Commentary

4(a)(1) Charges by Third Parties

1. ***Choosing the provider of a required service.*** *An example of a third-party charge included in the finance charge is the cost of required mortgage insurance, even if the consumer is allowed to choose the insurer.*

2. ***Annuities associated with reverse mortgages.*** *Some creditors offer annuities in connection with a reverse-mortgage transaction. The amount of the premium is a finance charge if the creditor requires the purchase of the annuity incident to the credit. Examples include the following:*

   i. The credit documents reflect the purchase of an annuity from a specific provider or providers.

   ii. The creditor assesses an additional charge on consumers who do not purchase an annuity from a specific provider.

   iii. The annuity is intended to replace in whole or in part the creditor's payments to the consumer either immediately or at some future date.

4(a)(2) Special Rule; Closing Agent Charges

1. ***General.*** *This rule applies to charges by a third party serving as the closing agent for the particular loan. An example of a closing agent charge included in the finance charge is a courier fee where the creditor requires the use of a courier.*

2. ***Required closing agent.*** *If the creditor requires the use of a closing agent, fees charged by the closing agent are included in the finance charge only if the creditor requires the particular service, requires the imposition of the charge, or retains a portion of the charge. Fees charged by a third-party closing agent may be otherwise excluded from the finance charge under §1026.4. For example, a fee that would be paid in a comparable cash transaction may be excluded under §1026.4(a). A charge for conducting or attending a closing is a finance charge and may be excluded only if the charge is included in and is incidental to a lump-sum fee excluded under §1026.4(c)(7).*

4(a)(3) Special Rule; Mortgage Broker Fees

1. ***General.*** *A fee charged by a mortgage broker is excluded from the finance charge if it is the type of fee that is also excluded when charged by the creditor. For example, to exclude an application fee from the finance charge under §1026.4(c)(1), a mortgage broker must charge the fee to all applicants for credit, whether or not credit is extended.*

2. ***Coverage.*** *This rule applies to charges paid by consumers to a mortgage broker in connection with a consumer credit transaction secured by real property or a dwelling.*

3. ***Compensation by lender.*** *The rule requires all mortgage broker fees to be included in the finance charge. Creditors sometimes compensate mortgage brokers under a separate arrangement with those parties. Creditors may draw on amounts paid by the consumer, such as points or closing costs, to fund their payment to the broker. Compensation paid by a creditor to a mortgage broker under an agreement is not included as a separate component of a consumer's total finance charge (although this compensation may be reflected in the finance charge if it comes from amounts paid by the consumer to the creditor that are finance charges, such as points and interest).*

Section 2: Examples of Finance Charges 12 C.F.R. § 1026.4(b)

Examples of Finance Charges - 12 CFR § 1026.4(b)

Regulatory Discussion

The section provides more detailed examples of items that <u>are considered</u> a finance charge. It includes 11 examples.

Regulatory Text

(b) **Examples of finance charges.** The finance charge includes the following types of charges, except for charges specifically excluded by paragraphs (c) through (e) of this section:

(1) Interest, time price differential, and any amount payable under an add-on or discount system of additional charges.

(2) Service, transaction, activity, and carrying charges, including any charge imposed on a checking or other transaction account (except a prepaid account as defined in §1026.61) to the extent that the charge exceeds the charge for a similar account without a credit feature.

(3) Points, loan fees, assumption fees, finder's fees, and similar charges.

(4) Appraisal, investigation, and credit report fees.

(5) Premiums or other charges for any guarantee or insurance protecting the creditor against the consumer's default or other credit loss.

(6) Charges imposed on a creditor by another person for purchasing or accepting a consumer's obligation, if the consumer is required to pay the charges in cash, as an addition to the obligation, or as a deduction from the proceeds of the obligation.

(7) Premiums or other charges for credit life, accident, health, or loss-of-income insurance, written in connection with a credit transaction.

(8) Premiums or other charges for insurance against loss of or damage to property, or against liability arising out of the ownership or use of property, written in connection with a credit transaction.

(9) Discounts for the purpose of inducing payment by a means other than the use of credit.

(10) Charges or premiums paid for debt cancellation or debt suspension coverage written in connection with a credit transaction, whether or not the coverage is insurance under applicable law.

(11) With regard to a covered separate credit feature and an asset feature on a prepaid account that are both accessible by a hybrid prepaid-credit card as defined in §1026.61:

(i) Any fee or charge described in paragraphs (b)(1) through (10) of this section imposed on the covered separate credit feature, whether it is structured as a credit subaccount of the prepaid account or a separate credit account.

(ii) Any fee or charge imposed on the asset feature of the prepaid account to the extent that the amount of the fee or charge exceeds comparable fees or charges imposed on prepaid accounts in the same prepaid account program that do not have a covered separate credit feature accessible by a hybrid prepaid-credit card.

Regulatory Commentary

4(b) Examples of Finance Charges

1. ***Relationship to other provisions.*** *Charges or fees shown as examples of finance charges in §1026.4(b) may be excludable under §1026.4(c), (d), or (e). For example:*

i. Premiums for credit life insurance, shown as an example of a finance charge under §1026.4(b)(7), may be excluded if the requirements of §1026.4(d)(1) are met.

ii. Appraisal fees mentioned in §1026.4(b)(4) are excluded for real property or residential mortgage transactions under §1026.4(c)(7).

Paragraph 4(b)(2)

1. ***Checking or transaction account charges.*** *A charge imposed in connection with a credit feature on a checking or transaction account (other than a prepaid account as defined in §1026.61) is a finance charge under §1026.4(b)(2) to the extent the charge exceeds the charge for a similar account without a credit feature. If a charge for an account with a credit feature does not exceed the charge for an account without a credit feature, the charge is not a finance charge under §1026.4(b)(2). To illustrate:*

i. A $5 service charge is imposed on an account with an overdraft line of credit (where the institution has agreed in writing to pay an overdraft), while a $3 service charge is imposed on an account without a credit feature; the $2 difference is a finance charge. (If the difference is not related to account activity, however, it may be excludable as a participation fee. See the commentary to §1026.4(c)(4).)

ii. A $5 service charge is imposed for each item that results in an overdraft on an account with an overdraft line of credit, while a $25 service charge is imposed for paying or returning each item on a similar account without a credit feature; the $5 charge is not a finance charge.

2. ***Prepaid accounts.*** *Fee or charges related to credit offered in connection with prepaid accounts as defined in §1026.61 are discussed in §§1026.4(b)(11) and 1026.61 and related commentary.*

Paragraph 4(b)(3)

1. ***Assumption fees.*** *The assumption fees mentioned in §1026.4(b)(3) are finance charges only when the assumption occurs and the fee is imposed on the new buyer. The assumption fee is a finance charge in the new buyer's transaction.*

Paragraph 4(b)(5)

1. ***Credit loss insurance.*** *Common examples of the insurance against credit loss mentioned in §1026.4(b)(5) are mortgage guaranty insurance, holder in due course insurance, and repossession insurance. Such premiums must be included in the finance charge only for the period that the creditor requires the insurance to be maintained.*

2. ***Residual value insurance.*** *Where a creditor requires a consumer to maintain residual value insurance or where the creditor is a beneficiary of a residual value insurance policy written in connection with an extension of credit (as is the case in some forms of automobile balloon-payment financing, for example), the premiums for the insurance must be included in the finance charge for the period that the insurance is to be maintained. If a creditor pays for residual-value insurance and absorbs the payment as a cost of doing business, such costs are not considered finance charges. (See comment 4(a)-2.)*

Paragraphs 4(b)(7) and (b)(8)

1. ***Pre-existing insurance policy.*** *The insurance discussed in §1026.4(b)(7) and (b)(8) does not include an insurance policy (such as a life or an automobile collision insurance policy) that is already owned by the consumer, even if the policy is assigned to or otherwise made payable to the creditor to satisfy an insurance requirement. Such a policy is not "written in connection with" the transaction, as long as the insurance was not purchased for use in that credit extension, since it was previously owned by the consumer.*

2. ***Insurance written in connection with a transaction.*** *Credit insurance sold before or after an open-end (not home-secured) plan is opened is considered "written in connection with a credit transaction." Insurance sold after consummation in closed-end credit transactions or after the opening of a home-equity plan subject to the requirements of §1026.40 is not considered "written in connection with" the credit transaction if the insurance is written because of the consumer's default (for example, by failing to obtain or maintain required property insurance) or because the consumer requests insurance after consummation or the opening of a home-equity plan subject to the requirements of §1026.40 (although credit-sale disclosures may be required for the insurance sold after consummation if it is financed).*

3. ***Substitution of life insurance.*** *The premium for a life insurance policy purchased and assigned to satisfy a credit life insurance requirement must be included in the finance charge, but only to the extent of the cost of the credit life insurance if purchased from the creditor or the actual cost of the policy (if that is less than the cost of the insurance available from the creditor). If the creditor does not offer the required insurance, the premium to be included in the finance charge is the cost of a policy of insurance of the type, amount, and term required by the creditor.*

4. ***Other insurance.*** *Fees for required insurance not of the types described in §1026.4(b)(7) and (b)(8) are finance charges and are not excludable. For example, the premium for a hospitalization insurance policy, if it is required to be purchased only in a credit transaction, is a finance charge.*

Paragraph 4(b)(9)

1. ***Discounts for payment by other than credit.*** *The discounts to induce payment by other than credit mentioned in §1026.4(b)(9) include, for example, the following situation: The seller of land offers individual tracts for $10,000 each. If the purchaser pays cash, the price is $9,000, but if the purchaser finances the tract with the seller the price is $10,000. The $1,000 difference is a finance charge for those who buy the tracts on credit.*

2. ***Exception for cash discounts.***

   i. *Creditors may exclude from the finance charge discounts offered to consumers for using cash or another means of payment instead of using a credit card or an open-end plan. The discount may be in whatever amount the seller desires, either as a percentage of the regular price (as defined in section 103(z) of the Act, as amended) or a dollar amount. Pursuant to section 167(b) of the Act, this provision applies only to transactions involving an open-end credit plan or a credit card (whether open-end or closed-end credit is extended on the card). The merchant must offer the discount to prospective buyers whether or not they are cardholders or members of the open-end credit plan. The merchant may, however, make other distinctions. For example:*

      A. *The merchant may limit the discount to payment by cash and not offer it for payment by check or by use of a debit card.*

      B. *The merchant may establish a discount plan that allows a 15% discount for payment by cash, a 10% discount for payment by check, and a 5% discount for payment by a particular credit card. None of these discounts is a finance charge.*

   ii. *Pursuant to section 171(c) of the Act, discounts excluded from the finance charge under this paragraph are also excluded from treatment as a finance charge or other charge for credit under any state usury or disclosure laws.*

3. ***Determination of the regular price.***

   i. *The regular price is critical in determining whether the difference between the price charged to cash customers and credit customers is a discount or a surcharge, as these terms are defined in amended section 103 of the Act. The regular price is defined in section 103 of the Act as - * * * the tag or posted price charged for the property or service if a single price is tagged or posted, or the price charged for the property or service when payment is made by use of an open-end credit account or a credit card if either (1) no price is tagged or posted, or (2) two prices are tagged or posted * * *.*

   ii. *For example, in the sale of motor vehicle fuel, the tagged or posted price is the price displayed at the pump. As a result, the higher price (the open-end credit or credit card price) must be displayed at the pump, either alone or along with the cash price. Service station operators may designate separate pumps or separate islands as being for either cash or credit purchases and display only the appropriate prices at the* *various pumps. If a pump is capable of displaying on its meter either a cash or a credit price depending upon the consumer's means of payment, both the cash price and the credit price must be displayed at the pump. A service station operator may display the cash price of fuel by itself on a curb sign, as long as the sign clearly indicates that the price is limited to cash purchases.*

Paragraph 4(b)(10)

1. ***Definition.*** *Debt cancellation coverage provides for payment or satisfaction of all or part of a debt when a specified event occurs. The term "debt cancellation coverage" includes guaranteed automobile protection, or "GAP," agreements, which pay or satisfy the remaining debt after property insurance benefits are exhausted. Debt suspension coverage provides for suspension of the obligation to make one or more payments on the date(s) otherwise required by the credit agreement, when a specified event occurs. The term "debt suspension" does not include loan payment deferral arrangements in which the triggering event is the bank's unilateral decision to allow a deferral of payment and the borrower's unilateral election to do so, such as by skipping or reducing one or more payments ("skip payments").*

2. ***Coverage written in connection with a transaction.*** *Coverage sold after consummation in closed-end credit transactions or after the opening of a home-equity plan subject to the requirements of §1026.40 is not "written in connection with" the credit transaction if the coverage is written because the consumer requests coverage after consummation or the opening of a home-equity plan subject to the requirements of §1026.40 (although credit-sale disclosures may be required for the coverage sold after consummation if it is financed). Coverage sold before or after an open-end (not home-secured) plan is opened is considered "written in connection with a credit transaction."*

Paragraph 4(b)(11)

1. ***Credit in connection with a prepaid card.*** *Section 1026.61 governs credit offered in connection with a prepaid card.*

   i. A separate credit feature that meets the conditions of §1026.61(a)(2)(i) is defined as a covered separate credit feature accessible by a hybrid prepaid-credit card. See §1026.61(a)(2)(i) and comment 61(a)(2)-4. In this case, the hybrid prepaid-credit card can access both the covered separate credit feature and the asset feature of the prepaid account. The rules for classification of fees or charges as finance charges in connection with this account structure are specified in §1026.4(b)(11) and related commentary.

   ii. If a prepaid card can access a non-covered separate credit feature as described in §1026.61(a)(2)(ii), the card is not a hybrid prepaid-credit card with respect to that credit feature. In that case:

   A. Section 1026.4(b)(11) and related commentary do not apply to fees or charges imposed on the non-covered separate credit feature; instead, the general rules set forth in §1026.4 determine whether these fees or charges are finance charges; and

   B. Fees or charges on the asset feature of the prepaid account are not finance charges under §1026.4 with respect to the non-covered separate credit feature. See *comment 61(a)(2)-5.iii for guidance on the applicability of this regulation in connection with non-covered credit features accessible by prepaid cards.*

iii. If the prepaid card is not a hybrid prepaid-credit card because the only credit extended through a negative balance on the asset feature of the prepaid account is pursuant to §1026.61(a)(4), fees charged on the asset feature of the prepaid account in accordance with §1026.61(a)(4)(ii)(B) are not finance charges.

Paragraph 4(b)(11)(i)

1. ***Transaction fees imposed on the covered separate credit feature.*** *Consistent with comment 4(a)-4, any transaction charge imposed on a cardholder by a card issuer on a covered separate credit feature accessible by a hybrid prepaid-credit card is a finance charge. Transaction charges that are imposed on the asset feature of a prepaid account are subject to §1026.4(b)(11)(ii) and related commentary, instead of §1026.4(b)(11)(i).*

Paragraph 4(b)(11)(ii)

1. ***Fees or charges imposed on the asset feature of a prepaid account.***

i. Under §1026.4(b)(11)(ii), with regard to a covered separate credit feature and an asset feature of a prepaid account that are both accessible by a hybrid prepaid-credit card as defined §1026.61, any fee or charge imposed on the asset feature of the prepaid account is a finance charge to the extent that the amount of the fee or charge exceeds comparable fees or charges imposed on prepaid accounts in the same prepaid account program that do not have a covered separate credit feature accessible by a hybrid prepaid-credit card. This comment provides guidance with respect to comparable fees under §1026.4(b)(11)(ii) for the two types of credit extensions on a covered separate credit feature. See §1026.61(a)(2)(i)(B) and comment 61(a)(2)-4.ii. Comment 4(b)(11)(ii)-1.ii provides guidance for credit extensions where the hybrid prepaid-credit card accesses credit from the covered separate credit feature in the course of authorizing, settling, or otherwise completing a transaction conducted with the card to obtain goods or services, obtain cash, or conduct person-to-person transfers. Comment 4(b)(11)(ii)-1.iii provides guidance for credit extensions where a consumer draws or transfers credit from the covered separate credit feature outside the course of a transaction conducted with the card to obtain goods or services, obtain cash, or conduct person-to-person transfers.

ii. Where the hybrid prepaid-credit card accesses credit from a covered separate credit feature in the course of authorizing, settling, or otherwise completing a transaction conducted with the card to obtain goods or services, obtain cash, or conduct person-to-person transfers, any per transaction fees imposed on the asset feature of prepaid accounts, including load and transfer fees, for such credit from the credit feature are comparable only to per transaction fees for each transaction to access funds in the asset feature of a prepaid account that are imposed on prepaid accounts in the same prepaid account program that does not have such a credit feature. Per transaction fees for a transaction that is conducted to load or draw funds into a prepaid account from some other source are not comparable for purposes of §1026.4(b)(11)(ii). To illustrate:

A. Assume a prepaid account issuer charges $0.50 on prepaid accounts without a covered separate credit feature for each transaction that accesses funds in the asset feature of the prepaid accounts. Also, assume that the prepaid account issuer charges $0.50 per transaction on the asset feature of prepaid accounts in the same prepaid program where the hybrid prepaid-credit card accesses credit from a covered separate credit feature in the course of a transaction. In this case, the $0.50 per transaction fee imposed on the asset feature of the prepaid account with a covered separate credit feature is not a finance charge.

B. Assume same facts as in paragraph A above, except that assume the prepaid account issuer charges $1.25 on the asset feature of a prepaid account for each transaction where the hybrid prepaid-credit card accesses credit from the covered separate credit feature in the course of the transaction. In this case, the additional $0.75 is a finance charge.

C. Assume a prepaid account issuer charges $0.50 on prepaid accounts without a covered separate credit feature for each transaction that accesses funds in the asset feature of the prepaid accounts. Assume also that the prepaid account issuer charges both a $0.50 per transaction fee and a $1.25 transfer fee on the asset feature of prepaid accounts in the same prepaid program where the hybrid prepaid-credit card accesses credit from a covered separate credit feature in the course of a transaction. In this case, both fees charged on a per-transaction basis for the credit transaction (i.e., a combined fee of $1.75 per transaction) must be compared to the $0.50 per transaction fee to access funds in the asset feature of the prepaid account without a covered separate credit feature. Accordingly, the $1.25 excess is a finance charge.

D. Assume same facts as in paragraph C above, except that assume the prepaid account issuer also charges a load fee of $1.25 whenever funds are transferred or loaded from a separate asset account, such as from a deposit account via a debit card, in the course of a transaction on prepaid accounts without a covered separate credit feature, in addition to charging a $0.50 per transaction fee. The $1.25 excess in paragraph C is still a finance charge because load or transfer fees that are charged on the asset feature of prepaid account for credit from the covered separate credit feature are compared only to per transaction fees imposed for accessing funds in the asset feature of the prepaid account for prepaid accounts without such a credit feature. Per transaction fees for a transaction that is conducted to load or draw funds into a prepaid account from some other source are not comparable for purposes of §1026.4(b)(11)(ii).

iii. A consumer may choose in a particular circumstance to draw or transfer credit from the covered separate credit feature outside the course of a transaction conducted with the card to obtain goods or services, obtain cash, or conduct person-to-person transfers. For example, a consumer may use the prepaid card at the prepaid account issuer's Web site to load funds from the covered separate credit feature outside the course of a transaction conducted with the card to obtain goods or services, obtain cash, or conduct person-to-person transfers. See §1026.61(a)(2)(i)(B) and comment 61(a)(2)-4.ii. In these situations, load or transfer fees imposed for draws or transfers of credit from the covered separate credit feature outside the course of a transaction are compared only with fees, if any, to load funds as a direct deposit of salary from an *employer or a direct deposit of government benefits that are charged on prepaid accounts without a covered separate credit feature. Fees imposed on prepaid accounts without a covered separate credit feature for a one-time load or transfer of funds from a separate asset account or from a non-covered separate credit feature are not comparable for purposes of §1026.4(b)(11)(ii). To illustrate:*

A. *Assume a prepaid account issuer charges a $1.25 load fee to transfer funds from a non-covered separate credit feature, such as a non-covered separate credit card account, into prepaid accounts that do not have a covered separate credit feature and does not charge a fee for a direct deposit of salary from an employer or a direct deposit of government benefits on those prepaid accounts. Assume the prepaid account issuer charges $1.25 on the asset feature of a prepaid account with a covered separate credit feature to load funds from the covered separate credit feature outside the course of a transaction. In this case, the $1.25 fee imposed on the asset feature of the prepaid account with a covered separate credit feature is a finance charge because no fee is charged for a direct deposit of salary from an employer or a direct deposit of government benefits on prepaid accounts without such a credit feature. Fees imposed on prepaid accounts without a covered separate credit feature for a one-time load or transfer of funds from a non-covered separate credit feature are not comparable for purposes of §1026.4(b)(11)(ii).*

B. *Assume that a prepaid account issuer charges a $1.25 load fee for a one-time transfer of funds from a separate asset account, such as from a deposit account via a debit card, to a prepaid account without a covered separate credit feature and does not charge a fee for a direct deposit of salary from an employer or a direct deposit of government benefits on those prepaid accounts. Assume the prepaid account issuer charges $1.25 on the asset feature of a prepaid account with a covered separate credit feature to load funds from the covered separate credit feature outside the course of a transaction. In this case, the $1.25 fee imposed on the asset feature of the prepaid account with a covered separate credit feature is a finance charge because no fee is charged for a direct deposit of salary from an employer or a direct deposit of government benefits on prepaid accounts without a covered separate credit feature. Fees imposed on prepaid accounts without a covered separate credit feature for a one-time load or transfer of funds from a separate asset account are not comparable for purposes of §1026.4(b)(11)(ii).*

2. ***Relation to Regulation E.*** *See Regulation E, 12 CFR 1005.18(g), which only permits a financial institution to charge the same or higher fees on the asset feature of a prepaid account with a covered separate credit feature accessible by a hybrid prepaid-credit card than the amount of a comparable fee it charges on prepaid accounts in the same prepaid account program without such a credit feature. Under that provision, a financial institution cannot charge a lower fee on the asset feature of a prepaid account with a covered separate credit feature accessible by a hybrid prepaid-credit card than the amount of a comparable fee it charges on prepaid accounts without such a credit feature in the same prepaid account program.*

Section 3: Charges Excluded from Finance Charges
12 C.F.R. § 1026.4(c)

Charges Excluded from Finance Charges - 12 CFR § 1026.4(c)

Regulatory Discussion

The section provides more detailed examples of items that are not considered a finance charge. There are 8 categories. The most significant category is number seven, which specifically discusses mortgage loans.

Regulatory Text

(c) **Charges excluded from the finance charge.** The following charges are not finance charges:

(1) Application fees charged to all applicants for credit, whether or not credit is actually extended.

(2) Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence.

(3) Charges imposed by a financial institution for paying items that overdraw an account, unless the payment of such items and the imposition of the charge were previously agreed upon in writing. This paragraph does not apply to credit offered in connection with a prepaid account as defined in §1026.61.

(4) Fees charged for participation in a credit plan, whether assessed on an annual or other periodic basis. This paragraph does not apply to a fee to participate in a covered separate credit feature accessible by a hybrid prepaid-credit card as defined in §1026.61, regardless of whether this fee is imposed on the credit feature or on the asset feature of the prepaid account.

(5) Seller's points.

(6) Interest forfeited as a result of an interest reduction required by law on a time deposit used as security for an extension of credit.

(7) **Real-estate related fees.** The following fees in a transaction secured by real property or in a residential mortgage transaction, if the fees are bona fide and reasonable in amount:

(i) Fees for title examination, abstract of title, title insurance, property survey, and similar purposes.

(ii) Fees for preparing loan-related documents, such as deeds, mortgages, and reconveyance or settlement documents.

(iii) Notary and credit-report fees.

(iv) Property appraisal fees or fees for inspections to assess the value or condition of the property if the service is performed prior to closing, including fees related to pest-infestation or flood-hazard determinations.

(v) Amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge.

(8) Discounts offered to induce payment for a purchase by cash, check, or other means, as provided in section 167(b) of the Act.

Regulatory Commentary

4(c) Charges Excluded From the Finance Charge

Paragraph 4(c)(1)

*1. **Application fees**. An application fee that is excluded from the finance charge is a charge to recover the costs associated with processing applications for credit. The fee may cover the costs of services such as credit reports, credit investigations, and appraisals. The creditor is free to impose the fee in only certain of its loan programs, such as mortgage loans. However, if the fee is to be excluded from the finance charge under §1026.4(c)(1), it must be charged to all applicants, not just to applicants who are approved or who actually receive credit.*

Paragraph 4(c)(2)

*1. **Late payment charges.***

i. Late payment charges can be excluded from the finance charge under §1026.4(c)(2) whether or not the person imposing the charge continues to extend credit on the account or continues to provide property or services to the consumer. In determining whether a charge is for actual unanticipated late payment on a 30-day account, for example, factors to be considered include:

A. The terms of the account. For example, is the consumer required by the account terms to pay the account balance in full each month? If not, the charge may be a finance charge.

B. The practices of the creditor in handling the accounts. For example, regardless of the terms of the account, does the creditor allow consumers to pay the accounts over a period of time without demanding payment in full or taking other action to collect? If no effort is made to collect the full amount due, the charge may be a finance charge.

ii. section 1026.4(c)(2) applies to late payment charges imposed for failure to make payments as agreed, as well as failure to pay an account in full when due.

2. ***Other excluded charges.*** *Charges for "delinquency, default, or a similar occurrence" include, for example, charges for reinstatement of credit privileges or for submitting as payment a check that is later returned unpaid.*

Paragraph 4(c)(3)

Paragraph 4(c)(3)

1. ***Assessing interest on an overdraft balance.*** *Except with respect to credit offered in connection with a prepaid account as defined in §1026.61, a charge on an overdraft balance computed by applying a rate of interest to the amount of the overdraft is not a finance charge, even though the consumer agrees to the charge in the account agreement, unless the financial institution agrees in writing that it will pay such items.*
2. ***Credit accessed in connection with a prepaid account.*** *See comment 4(b)(11)-1 for guidance on when fees imposed with regard to credit accessed in connection with a prepaid account as defined in §1026.61 are finance charges.*

Paragraph 4(c)(4)

1. ***Participation fees - periodic basis.****. The participation fees described in §1026.4(c)(4) do not necessarily have to be formal membership fees, nor are they limited to credit card plans. Except as provided in §1026.4(c)(4) for covered separate credit features accessible by hybrid prepaid-credit cards as defined in §1026.61, the provision applies to any credit plan in which payment of a fee is a condition of access to the plan itself, but it does not apply to fees imposed separately on individual closed-end transactions. The fee may be charged on a monthly, annual, or other periodic basis; a one-time, non-recurring fee imposed at the time an account is opened is not a fee that is charged on a periodic basis, and may not be treated as a participation fee.*
2. ***Participation fees - exclusions.*** *Minimum monthly charges, charges for non-use of a credit card, and other charges based on either account activity or the amount of credit available under the plan are not excluded from the finance charge by §1026.4(c)(4). Thus, for example, a fee that is charged and then refunded to the consumer based on the extent to which the consumer uses the credit available would be a finance charge. (See the commentary to §1026.4(b)(2). Also, see comment 14(c)-2 for treatment of certain types of fees excluded in determining the annual percentage rate for the periodic statement.)*
3. ***Credit accessed in connection with by a prepaid account.*** *See comment 4(b)(11)-1 for guidance on when fees imposed with regard to credit accessed in connection with a prepaid account as defined in §1026.61 are finance charges.*

Paragraph 4(c)(5)

1. **Seller's points.** *The seller's points mentioned in §1026.4(c)(5) include any charges imposed by the creditor upon the noncreditor seller of property for providing credit to the buyer or for providing credit on certain terms. These charges are excluded from the finance charge even if they are passed on to the buyer, for example, in the form of a higher sales price. Seller's points are frequently involved in real estate transactions guaranteed or insured by governmental agencies. A commitment fee paid by a noncreditor seller (such as a real estate developer) to the creditor should be treated as seller's points. Buyer's points (that is, points charged to the buyer by the creditor), however, are finance charges.*

2. ***Other seller-paid amounts.*** *Mortgage insurance premiums and other finance charges are sometimes paid at or before consummation or settlement on the borrower's behalf by a non-creditor seller. The creditor should treat the payment made by the seller as seller's points and exclude it from the finance charge if, based on the seller's payment, the consumer is not legally bound to the creditor for the charge. A creditor who gives disclosures before the payment has been made should base them on the best information reasonably available.*

Paragraph 4(c)(6)

1. ***Lost interest.*** *Certain Federal and state laws mandate a percentage differential between the interest rate paid on a deposit and the rate charged on a loan secured by that deposit. In some situations, because of usury limits the creditor must reduce the interest rate paid on the deposit and, as a result, the consumer loses some of the interest that would otherwise have been earned. Under §1026.4(c)(6), such "lost interest" need not be included in the finance charge. This rule applies only to an interest reduction imposed because a rate differential is required by law and a usury limit precludes compliance by any other means. If the creditor imposes a differential that exceeds that required, only the lost interest attributable to the excess amount is a finance charge. (See the commentary to §1026.4(a).)*

4(c)(7) Real-Estate Related Fees

1. ***Real estate or residential mortgage transaction charges.*** *The list of charges in §1026.4(c)(7) applies both to residential mortgage transactions (which may include, for example, the purchase of a mobile home) and to other transactions secured by real estate. The fees are excluded from the finance charge even if the services for which the fees are imposed are performed by the creditor's employees rather than by a third party. In addition, the cost of verifying or confirming information connected to the item is also excluded. For example, credit-report fees cover not only the cost of the report but also the cost of verifying information in the report. In all cases, charges excluded under §1026.4(c)(7) must be bona fide and reasonable.*

2. ***Lump-sum charges.*** *If a lump sum charged for several services includes a charge that is not excludable, a portion of the total should be allocated to that service and included in the finance charge. However, a lump sum charged for conducting or attending a closing (for example, by a lawyer or a title company) is excluded from the finance charge if the charge is primarily for services related to items listed in §1026.4(c)(7) (for example, reviewing or completing documents), even if other incidental services such as explaining various documents or disbursing funds for the parties are performed. The entire charge is excluded even if a fee for the incidental services would be a finance charge if it were imposed separately.*

3. ***Charges assessed during the loan term.*** *Real estate or residential mortgage transaction charges excluded under §1026.4(c)(7) are those charges imposed solely in connection with the initial decision to grant credit. This would include, for example, a fee to search for tax liens on the property or to determine if flood insurance is required. The exclusion does not apply to fees for services to be performed periodically during the loan term, regardless of when the fee is collected. For example, a fee for one or more determinations during the loan term of the current tax-lien status or flood-insurance requirements is a finance charge, regardless of whether the fee is imposed at closing, or when the service is performed. If a creditor is uncertain about what portion of a fee to be paid at consummation or loan closing is related to the initial decision to grant credit, the entire fee may be treated as a finance charge.*

Section 4: Insurance, Debt Cancellation, Debt Suspension Coverage

12 C.F.R. § 1026.4(d)

Initial Commentary - Insurance, Debt Cancellation, Debt Suspension Coverage - 12 CFR § 1026.4(d)

Regulatory Discussion

This is preamble commentary that precedes the regulatory text regarding Insurance, Debt Cancellation, and Debt Suspension Coverage.

Regulatory Text

None.

Regulatory Commentary

4(d) Insurance and Debt Cancellation and Debt Suspension Coverage

1. ***General.*** *Section 1026.4(d) permits insurance premiums and charges and debt cancellation and debt suspension charges to be excluded from the finance charge. The required disclosures must be made in writing, except as provided in §1026.4(d)(4). The rules on location of insurance and debt cancellation and debt suspension disclosures for closed-end transactions are in §1026.17(a). For purposes of §1026.4(d), all references to insurance also include debt cancellation and debt suspension coverage unless the context indicates otherwise.*

2. ***Timing of disclosures.*** *If disclosures are given early, for example under §1026.17(f) or §1026.19(a), the creditor need not redisclose if the actual premium is different at the time of consummation. If insurance disclosures are not given at the time of early disclosure and insurance is in fact written in connection with the transaction, the disclosures under §1026.4(d) must be made in order to exclude the premiums from the finance charge.*

3. ***Premium rate increases.*** *The creditor should disclose the premium amount based on the rates currently in effect and need not designate it as an estimate even if the premium rates may increase. An increase in insurance rates after consummation of a closed-end credit transaction or during the life of an open-end credit plan does not require redisclosure in order to exclude the additional premium from treatment as a finance charge.*

4. ***Unit-cost disclosures.***

    i. ***Open-end credit.*** *The premium or fee for insurance or debt cancellation or debt suspension for the initial term of coverage may be disclosed on a unit-cost basis in open-end credit transactions. The cost per unit should be based on the initial term of coverage, unless one of the options under comment 4(d)-12 is available.*

    ii. ***Closed-end credit.*** *One of the transactions for which unit-cost disclosures (such as 50* *cents per year for each $100 of the amount financed) may be used in place of the total insurance premium involves a particular kind of insurance plan. For example, a consumer with a current indebtedness of $8,000 is covered by a plan of credit life insurance coverage with a maximum of $10,000. The consumer requests an additional $4,000 loan to be covered by the same insurance plan. Since the $4,000 loan exceeds, in part, the maximum amount of indebtedness that can be covered by the plan, the creditor may properly give the insurance-cost disclosures on the $4,000 loan on a unit-cost basis.*

5. ***Required credit life insurance; debt cancellation or suspension coverage.*** *Credit life, accident, health, or loss-of-income insurance, and debt cancellation and suspension coverage described in §1026.4(b)(10), must be voluntary in order for the premium or charges to be excluded from the finance charge. Whether the insurance or coverage is in fact required or optional is a factual question. If the insurance or coverage is required, the premiums must be included in the finance charge, whether the insurance or coverage is purchased from the creditor or from a third party. If the consumer is required to elect one of several options—such as to purchase credit life insurance, or to assign an existing life insurance policy, or to pledge security such as a certificate of deposit—and the consumer purchases the credit life insurance policy, the premium must be included in the finance charge. (If the consumer assigns a preexisting policy or pledges security instead, no premium is included in the finance charge. The security interest would be disclosed under §1026.6(a)(4), §1026.6(b)(5)(ii), or §1026.18(m). See the commentary to §1026.4(b)(7) and (b)(8).)*

6. ***Other types of voluntary insurance.*** *Insurance is not credit life, accident, health, or loss-of-income insurance if the creditor or the credit account of the consumer is not the beneficiary of the insurance coverage. If the premium for such insurance is not imposed by the creditor as an incident to or a condition of credit, it is not covered by §1026.4.*

7. ***Signatures.*** *If the creditor offers a number of insurance options under §1026.4(d), the creditor may provide a means for the consumer to sign or initial for each option, or it may provide for a single authorizing signature or initial with the options selected designated by some other means, such as a check mark. The insurance authorization may be signed or initialed by any consumer, as defined in §1026.2(a)(11), or by an authorized user on a credit card account.*

8. ***Property insurance.*** *To exclude property insurance premiums or charges from the finance charge, the creditor must allow the consumer to choose the insurer and disclose that fact. This disclosure must be made whether or not the property insurance is available from or through the creditor. The requirement that an option be given does not require that the insurance be readily available from other sources. The premium or charge must be disclosed only if the consumer elects to purchase the insurance from the creditor; in such a case, the creditor must also disclose the term of the property insurance coverage if it is less than the term of the obligation.*

9. ***Single-interest insurance.*** *Blanket and specific single-interest coverage are treated the same for purposes of the regulation. A charge for either type of single-interest insurance may be excluded from the finance charge if:*

   i. The insurer waives any right of subrogation.

   ii. The other requirements of §1026.4(d)(2) are met. This includes, of course, giving the consumer the option of obtaining the insurance from a person of the consumer's choice. The creditor need not ascertain whether the consumer is able to purchase the insurance from someone else.

10. ***Single-interest insurance defined.*** *The term single-interest insurance as used in the regulation refers only to the types of coverage traditionally included in the term vendor's single-interest insurance (or VSI), that is, protection of tangible property against normal property damage, concealment, confiscation, conversion, embezzlement, and skip. Some comprehensive insurance policies may include a variety of additional coverages, such as repossession insurance and holder-in-due-course insurance. These types of coverage do not constitute single-interest insurance for purposes of the regulation, and premiums for them do not qualify for exclusion from the finance charge under §1026.4(d). If a policy that is primarily VSI also provides coverages that are not VSI or other property insurance, a portion of the premiums must be allocated to the nonexcludable coverages and included in the finance charge. However, such allocation is not required if the total premium in fact attributable to all of the non-VSI coverages included in the policy is $1.00 or less (or $5.00 or less in the case of a multiyear policy).*

11. ***Initial term.***

   i. *The initial term of insurance or debt cancellation or debt suspension coverage determines the period for which a premium amount must be disclosed, unless one of the options discussed under comment 4(d)-12 is available. For purposes of §1026.4(d), the initial term is the period for which the insurer or creditor is obligated to provide coverage, even though the consumer may be allowed to cancel the coverage or coverage may end due to nonpayment before that term expires.*

   ii. *For example:*

      A. *The initial term of a property insurance policy on an automobile that is written for one year is one year even though premiums are paid monthly and the term of the credit transaction is four years.*

      B. *The initial term of an insurance policy is the full term of the credit transaction if the consumer pays or finances a single premium in advance.*

12. ***Initial term; alternative.***

   i. ***General.*** *A creditor has the option of providing cost disclosures on the basis of one year of insurance or debt cancellation or debt suspension coverage instead of a longer initial term (provided the premium or fee is clearly labeled as being for one year) if:*

      A. *The initial term is indefinite or not clear, or*

      B. *The consumer has agreed to pay a premium or fee that is assessed periodically but the consumer is under no obligation to continue the coverage, whether or not the consumer has made an initial payment.*

   ii. ***Open-end plans.*** *For open-end plans, a creditor also has the option of providing unit-cost disclosure on the basis of a period that is less than one year if the consumer has agreed to pay a premium or fee that is assessed periodically, for example monthly, but the consumer is under no obligation to continue the coverage.*

   iii. ***Examples.*** *To illustrate:*

      A. *A credit life insurance policy providing coverage for a 30-year mortgage loan has an initial term of 30 years, even though premiums are paid monthly and the consumer is not required to continue the coverage. Disclosures may be based on the initial term, but* *the creditor also has the option of making disclosures on the basis of coverage for an assumed initial term of one year.*

13. ***Loss-of-income insurance.*** *The loss-of-income insurance mentioned in §1026.4(d) includes involuntary unemployment insurance, which provides that some or all of the consumer's payments will be made if the consumer becomes unemployed involuntarily.*

Voluntary Credit Insurance Premiums - 12 CFR § 1026.4(d)(1)

Regulatory Discussion

Generally, this type of insurance cannot be sold at closing. If at all, it is sold after the fact, and therefore, we have omitted this section.

Property Insurance Premiums - 12 CFR § 1026.4(d)(2)

Regulatory Discussion

This section provides specific discussion regarding premiums for property insurance premiums. If proper steps are taken, this insurance is <u>not</u> finance charge.

Regulatory Text

(2) **Property insurance premiums.** Premiums for insurance against loss of or damage to property, or against liability arising out of the ownership or use of property, including single interest insurance if the insurer waives all right of subrogation against the consumer, may be excluded from the finance charge if the following conditions are met:

(i) The insurance coverage may be obtained from a person of the consumer's choice, and this fact is disclosed. (A creditor may reserve the right to refuse to accept, for reasonable cause, an insurer offered by the consumer.)

(ii) If the coverage is obtained from or through the creditor, the premium for the initial term of insurance coverage shall be disclosed. If the term of insurance is less than the term of the transaction, the term of insurance shall also be disclosed. The premium may be disclosed on a unit-cost basis only in open-end credit transactions, closed-end credit transactions by mail or telephone under §1026.17(g), and certain closed-end credit transactions involving an insurance plan that limits the total amount of indebtedness subject to coverage.

Regulatory Commentary

None.

Voluntary Debt Cancellation or Debt Suspension Fees - 12 CFR § 1026.4(d)(3)

Regulatory Discussion

Generally, this type of insurance cannot be sold at closing. If at all, it is sold after the fact, and therefore, we have omitted this section.

Telephone Purchases - 12 CFR § 1026.4(d)(4)

Regulatory Discussion

Generally, this does not occur in a mortgage loan, and therefore, we have omitted this section.

Section 5: Certain Security Interest Charges and Prohibited Offsets

12 C.F.R. § 1026.4(e) and 12 C.F.R. § 1026.4(f)

Certain Security Interest Charges - 12 CFR § 1026.4(e)

Regulatory Discussion

In certain instances, several security interest charges may be excluded from the finance charge.

Regulatory Text

(e) **Certain security interest charges.** If itemized and disclosed, the following charges may be excluded from the finance charge:

(1) Taxes and fees prescribed by law that actually are or will be paid to public officials for determining the existence of or for perfecting, releasing, or satisfying a security interest.

(2) The premium for insurance in lieu of perfecting a security interest to the extent that the premium does not exceed the fees described in paragraph (e)(1) of this section that otherwise would be payable.

(3) **Taxes on security instruments.** Any tax levied on security instruments or on documents evidencing indebtedness if the payment of such taxes is a requirement for recording the instrument securing the evidence of indebtedness.

Regulatory Commentary

4(e) Certain Security Interest Charges

1. ***Examples.***

i. ***Excludable charges.*** *Sums must be actually paid to public officials to be excluded from the finance charge under §1026.4(e)(1) and (e)(3). Examples are charges or other fees required for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents, as well as intangible property or other taxes even when the charges or fees are imposed by the state solely on the creditor and charged to the consumer (if the tax must be paid to record a security agreement). (See comment 4(a)-5 regarding the treatment of taxes, generally.)*

ii. ***Charges not excludable.*** *If the obligation is between the creditor and a third party (an assignee, for example), charges or other fees for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents relating to that obligation are not excludable from the finance charge under this section.*

2. ***Itemization.*** *The various charges described in §1026.4(e)(1) and (e)(3) may be totaled and disclosed as an aggregate sum, or they may be itemized by the specific fees and taxes imposed. If an aggregate sum is disclosed, a general term such as security interest fees or filing fees may be used.*

3. ***Notary fees.*** *In order for a notary fee to be excluded under §1026.4(e)(1), all of the following conditions must be met:*

   i. The document to be notarized is one used to perfect, release, or continue a security interest.

   ii. The document is required by law to be notarized.

   iii. A notary is considered a public official under applicable law.

   iv. The amount of the fee is set or authorized by law.

i. The fee for perfecting 4. ***Nonfiling insurance.*** *The exclusion in §1026.4(e)(2) is available only if nonfiling insurance is purchased. If the creditor collects and simply retains a fee as a sort of "self-insurance" against nonfiling, it may not be excluded from the finance charge. If the nonfiling insurance premium exceeds the amount of the fees excludable from the finance charge under §1026.4(e)(1), only the excess is a finance charge. For example:*

a security interest is $5.00 and the fee for releasing the security interest is $3.00. The creditor charges $10.00 for nonfiling insurance. Only $8.00 of the $10.00 is excludable from the finance charge.

Prohibited Offsets - 12 C.F.R. § 1026.4(f)

Regulatory Discussion

Finally, this section describes prohibited offsets to the computed finance charge the consumer may not receive on deposits or investments.

Regulatory Text

(f) **Prohibited offsets.** Interest, dividends, or other income received or to be received by the consumer on deposits or investments shall not be deducted in computing the finance charge.

Regulatory Commentary

4(f) Prohibited Offsets

1. ***Earnings on deposits or investments.*** *The rule that the creditor shall not deduct any earnings by the consumer on deposits or investments applies whether or not the creditor has a security interest in the property.*

Knowledge Preparation

Regulation B

Section 1: Authority, Purpose, and Scope
12 CFR § 1002.1

Authority and Scope - 12 CFR § 1002.1(a)

Regulatory Discussion

The Equal Credit Opportunity Act (ECOA) prohibits discrimination in any aspect of a credit transaction and applies to any extension of credit, including extensions of credit to individuals, small businesses, corporations, partnerships, and trusts.

The CFPB's Regulation B, implementing the ECOA, describes lending acts and practices that are specifically prohibited, permitted, or required.

Note the commentary on both methods of credit evaluation (judgmental or credit scoring) under "scope" as well as "foreign applicability."

- With respect to methods of credit evaluation, refer to the definitions in §1002.2(p) and (t).
- With respect to foreign applicability, Regulation B only applies to lending activities that take place within the United States without regard to whether or not the applicant is a United States' citizen. This statement should not be confused with the "national origin" prohibited base discussed under §1002.1(b) nor the "immigration status" discussed under §1002.6(b)(7).

Regulatory Text

(a) **Authority and scope.** This part, known as Regulation B, is issued by the Bureau of Consumer Financial Protection (Bureau) pursuant to title VII (Equal Credit Opportunity Act) of the Consumer Credit Protection Act, as amended (15 U.S.C. 1601 et seq.). Except as otherwise provided herein, this part applies to all persons who are creditors, as defined in §1002.2(l), other than a person excluded from coverage of this part by section 1029 of the Consumer Financial Protection Act of 2010, title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376. Information collection requirements contained in this part have been approved by the Office of Management and Budget under the provisions of 44 U.S.C. 3501 et seq. and have been assigned OMB No. 3170-0013.

Regulatory Commentary

1(a) Authority and scope.

1. ***Scope.*** *The Equal Credit Opportunity Act and Regulation B apply to all credit - commercial as well as personal—without regard to the nature or type of the credit or the creditor, except for an entity excluded from coverage of this part (but not the Act) by section 1029 of the Consumer Financial Protection Act of 2010 (12 U.S.C. 5519). If a transaction provides for the deferral of*

the payment of a debt, it is credit covered by Regulation B even though it may not be a credit transaction covered by Regulation Z (Truth in Lending) (12 CFR part 1026). Further, the definition of creditor is not restricted to the party or person to whom the obligation is initially payable, as is the case under Regulation Z. Moreover, the Act and regulation apply to all methods of credit evaluation, whether performed judgmentally or by use of a credit scoring system.

2. ***Foreign applicability.*** *Regulation B generally does not apply to lending activities that occur outside the United States. The regulation does apply to lending activities that take place within the United States (as well as the Commonwealth of Puerto Rico and any territory or possession of the United States), whether or not the applicant is a citizen.*

3. ***Bureau.*** *The term Bureau, as used in this part, means the Bureau of Consumer Financial Protection.*

Purpose - 12 CFR § 1002.1(b)

Regulatory Discussion

Regulation B prohibits discrimination based on the following factors:

- Race
- Color;
- Religion;
- National origin;
- Sex;
- Marital status;
- Age (provided the applicant has the capacity to contract (usually addressed in State law));
- The applicant's receipt of income derived from any public assistance program; or
- The applicant's exercise, in good faith, of any right under the Consumer Protection Act.

"Prohibited basis" refers not only to the characteristics of an applicant (or officers of an applicant in the case of a corporation) but also to the characteristics of individuals with whom an applicant is affiliated or with whom the applicant associates. This means, for example, that a creditor may not discriminate against an applicant because of that person's personal or business dealings with members of a certain religion, because of the national origin of any persons associated with the extension of credit (such as the tenants in the apartment complex being financed), or because of the race of other residents in the neighborhood where the property offered as collateral is located.

Any Federal, state, or local governmental assistance program that provides a continuing, periodic income supplement, whether premised on entitlement or need, is considered "public assistance." The term includes (but is not limited to) Aid to Families with Dependent Children, food stamps, rent and mortgage supplement or assistance programs, Social Security and Supplemental Security Income, and unemployment compensation. Only physicians, hospitals, and others to whom the benefits are payable need to consider Medicare and Medicaid as public assistance.

Further information on these factors will be discussed in greater detail in Sections 4 through 7 of this manual.

Regulation B requires creditors to:

- Notify applicants of action taken on their applications (see Section 9, §1002.9);
- Report credit history in the names of both spouses on an account (see Section 10, §1002.10);
- Retain records of credit applications (see Section 12, §1002.12);
- Collect information about the applicant's race and other personal characteristics in applications for certain dwelling related loans (see Section 13, §1002.13); and
- Provide applicants with copies of appraisal reports used in connection with credit transactions (see Section 14, §1002.14).

Regulatory Text

(b) **Purpose.** The purpose of this part is to promote the availability of credit to all creditworthy applicants without regard to race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract); to the fact that all or part of the applicant's income derives from a public assistance program; or to the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The regulation prohibits creditor practices that discriminate on the basis of any of these factors. The regulation also requires creditors to notify applicants of action taken on their applications; to report credit history in the names of both spouses on an account; to retain records of credit applications; to collect information about the applicant's race and other personal characteristics in applications for certain dwelling-related loans; and to provide applicants with copies of appraisal reports used in connection with credit transactions.

Regulatory Commentary

None.

Section 2: Definitions
12 CFR §1002.2

Introductory Regulatory Text

For the purposes of this part, unless the context indicates otherwise, the following definitions apply.

Account - 12 CFR § 1002.2(a)

Regulatory Text

(a) **Account** means an extension of credit. When employed in relation to an account, the word use refers only to open-end credit.

Regulatory Commentary

None.

Act - 12 CFR § 1002.2(b)

Regulatory Text

(b) **Act** means the Equal Credit Opportunity Act (Title VII of the Consumer Credit Protection Act).

Regulatory Commentary

None.

Adverse Action - 12 CFR § 1002.2(c)

Regulatory Text

(c) **Adverse action.**

(1) **The term means:**

(i) A refusal to grant credit in substantially the amount or on substantially the terms requested in an application unless the creditor makes a counteroffer (to grant credit in a different amount or on other terms) and the applicant uses or expressly accepts the credit offered;

(ii) A termination of an account or an unfavorable change in the terms of an account that does not affect all or substantially all of a class of the creditor's accounts; or

(iii) A refusal to increase the amount of credit available to an applicant who has made an application for an increase.

(2) **The term does not include:**

(i) A change in the terms of an account expressly agreed to by an applicant;

(ii) Any action or forbearance relating to an account taken in connection with inactivity, default, or delinquency as to that account;

(iii) A refusal or failure to authorize an account transaction at point of sale or loan, except when the refusal is a termination or an unfavorable change in the terms of an account that does not affect all or substantially all of a class of the creditor's accounts, or when the refusal is a denial of an application for an increase in the amount of credit available under the account;

(iv) A refusal to extend credit because applicable law prohibits the creditor from extending the credit requested; or

(v) A refusal to extend credit because the creditor does not offer the type of credit or credit plan requested.

(3) An action that falls within the definition of both paragraphs (c)(1) and (c)(2) of this section is governed by paragraph (c)(2) of this section.

Regulatory Commentary

2(c) Adverse action.

Paragraph 2(c)(1)(i).

*1. **Application for credit.** If the applicant applied in accordance with the creditor's procedures, a refusal to refinance or extend the term of a business or other loan is adverse action.*

Paragraph 2(c)(1)(ii).

*1. **Move from service area.** If a credit card issuer terminates the open-end account of a customer because the customer has moved out of the card issuer's service area, the termination is adverse action unless termination on this ground was explicitly provided for in the credit agreement between the parties. In cases where termination is adverse action, notification is required under §1002.9.*

*2. **Termination based on credit limit.** If a creditor terminates credit accounts that have low credit limits (for example, under $400) but keeps open accounts with higher credit limits, the termination is adverse action and notification is required under §1002.9.*

Paragraph 2(c)(2)(ii).

1. ***Default - exercise of due-on-sale clause.*** *If a mortgagor sells or transfers mortgaged property without the consent of the mortgagee, and the mortgagee exercises its contractual right to accelerate the mortgage loan, the mortgagee may treat the mortgagor as being in default. An adverse action notice need not be given to the mortgagor or the transferee. (See comment 2(e)-1 for treatment of a purchaser who requests to assume the loan.)*

2. ***Current delinquency or default.*** *The term adverse action does not include a creditor's termination of an account when the accountholder is currently in default or delinquent on that account. Notification in accordance with §1002.9 of the regulation generally is required, however, if the creditor's action is based on a past delinquency or default on the account.*

Paragraph 2(c)(2)(iii).

1. ***Point-of-sale transactions.*** *Denial of credit at point of sale is not adverse action except under those circumstances specified in the regulation. For example, denial at point of sale is not adverse action in the following situations:*

   i. A credit cardholder presents an expired card or a card that has been reported to the card issuer as lost or stolen.

   ii. The amount of a transaction exceeds a cash advance or credit limit.

   iii. The circumstances (such as excessive use of a credit card in a short period of time) suggest that fraud is involved.

   iv. The authorization facilities are not functioning.

   v. Billing statements have been returned to the creditor for lack of a forwarding address.

2. ***Application for increase in available credit.*** *A refusal or failure to authorize an account transaction at the point of sale or loan is not adverse action except when the refusal is a denial of an application, submitted in accordance with the creditor's procedures, for an increase in the amount of credit.*

Paragraph 2(c)(2)(v).

1. ***Terms of credit versus type of credit offered.*** *When an applicant applies for credit and the creditor does not offer the credit terms requested by the applicant (for example, the interest rate, length of maturity, collateral, or amount of downpayment), a denial of the application for that reason is adverse action (unless the creditor makes a counteroffer that is accepted by the applicant) and the applicant is entitled to notification under §1002.9.*

Age - 12 CFR § 1002.2(d)

Regulatory Text

(d) **Age** refers only to the age of natural persons and means the number of fully elapsed years from the date of an applicant's birth.

Regulatory Commentary

None.

Applicant - 12 CFR § 1002.2(e)

Regulatory Text

(e) **Applicant** means any person who requests or who has received an extension of credit from a creditor, and includes any person who is or may become contractually liable regarding an extension of credit. For purposes of §1002.7(d), the term includes guarantors, sureties, endorsers, and similar parties.

Regulatory Commentary

2(e) Applicant.

*1. **Request to assume loan.** If a mortgagor sells or transfers the mortgaged property and the buyer makes an application to the creditor to assume the mortgage loan, the mortgagee must treat the buyer as an applicant unless its policy is not to permit assumptions.*

Application - 12 CFR § 1002.2(f)

Regulatory Text

(f) **Application** means an oral or written request for an extension of credit that is made in accordance with procedures used by a creditor for the type of credit requested. The term application does not include the use of an account or line of credit to obtain an amount of credit that is within a previously established credit limit. A *completed application* means an application in connection with which a creditor has received all the information that the creditor regularly obtains and considers in evaluating applications for the amount and type of credit requested (including, but not limited to, credit reports, any additional information requested from the applicant, and any approvals or reports by governmental agencies or other persons that are necessary to guarantee, insure, or provide security for the credit or collateral). The creditor shall exercise reasonable diligence in obtaining such information.

Regulatory Commentary

2(f) Application.

*1. **General.** A creditor has the latitude under the regulation to establish its own application process and to decide the type and amount of information it will require from credit applicants.*

*2. **Procedures used.** The term "procedures" refers to the actual practices followed by a creditor for making credit decisions as well as its stated application procedures. For example, if a creditor's stated policy is to require all applications to be in writing on the creditor's application form, but the creditor also makes credit decisions based on oral requests, the creditor's procedures are to accept both oral and written applications.*

*3. **When an inquiry or prequalification request becomes an application.** A creditor is* *encouraged to provide consumers with information about loan terms. However, if in giving information to the consumer the creditor also evaluates information about the consumer, decides to decline the request, and communicates this to the consumer, the creditor has treated the inquiry or prequalification request as an application and must then comply with the notification requirements under §1002.9. Whether the inquiry or prequalification request becomes an application depends on how the creditor responds to the consumer, not on what the consumer says or asks. (See comment 9-5 for further discussion of prequalification requests; see comment 2(f)-5 for a discussion of preapproval requests.)*

4. ***Examples of inquiries that are not applications.*** *The following examples illustrate situations in which only an inquiry has taken place:*

   i. A consumer calls to ask about loan terms and an employee explains the creditor's basic loan terms, such as interest rates, loan-to-value ratio, and debt-to-income ratio.

   ii. A consumer calls to ask about interest rates for car loans, and, in order to quote the appropriate rate, the loan officer asks for the make and sales price of the car and the amount of the downpayment, then gives the consumer the rate.

   iii. A consumer asks about terms for a loan to purchase a home and tells the loan officer her income and intended downpayment, but the loan officer only explains the creditor's loan-to-value ratio policy and other basic lending policies, without telling the consumer whether she qualifies for the loan.

   iv. A consumer calls to ask about terms for a loan to purchase vacant land and states his income and the sales price of the property to be financed, and asks whether he qualifies for a loan; the employee responds by describing the general lending policies, explaining that he would need to look at all of the consumer's qualifications before making a decision, and offering to send an application form to the consumer.

5. ***Examples of an application.*** *An application for credit includes the following situations:*

   i. A person asks a financial institution to "preapprove" her for a loan (for example, to finance a house or a vehicle she plans to buy) and the institution reviews the request under a program in which the institution, after a comprehensive analysis of her creditworthiness, issues a written commitment valid for a designated period of time to extend a loan up to a specified amount. The written commitment may not be subject to conditions other than conditions that require the identification of adequate collateral, conditions that require no material change in the applicant's financial condition or creditworthiness prior to funding the loan, and limited conditions that are not related to the financial condition or creditworthiness of the applicant that the lender ordinarily attaches to a traditional application (such as certification of a clear termite inspection for a home purchase loan, or a maximum mileage requirement for a used car loan). But if the creditor's program does not provide for giving written commitments, requests for preapprovals are treated as prequalification requests for purposes of the regulation.

   ii. Under the same facts as above, the financial institution evaluates the person's creditworthiness and determines that she does not qualify for a preapproval.

6. ***Completed application - diligence requirement.*** *The regulation defines a completed application in terms that give a creditor the latitude to establish its own information requirements. Nevertheless, the creditor must act with reasonable diligence to collect information needed to complete the application. For example, the creditor should request*

information from third parties, such as a credit report, promptly after receiving the application. If additional information is needed from the applicant, such as an address or a telephone number to verify employment, the creditor should contact the applicant promptly. (But see comment 9(a)(1)-3, which discusses the creditor's option to deny an application on the basis of incompleteness.)

Business Credit - 12 CFR § 1002.2(g)

Omitted.

Consumer Credit - 12 CFR § 1002.2(h)

Regulatory Text

(h) **Consumer credit** means credit extended to a natural person primarily for personal, family, or household purposes.

Regulatory Commentary

None.

Contractually Liable - 12 CFR § 1002.2(i)

Regulatory Text

(i) **Contractually liable** means expressly obligated to repay all debts arising on an account by reason of an agreement to that effect.

Regulatory Commentary

None.

Credit - 12 CFR § 1002.2(j)

Omitted.

Credit Card - 12 CFR § 1002.2(k)

Omitted.

Creditor - 12 CFR § 1002.2(l)

Regulatory Text

(l) **Creditor** means a person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of the credit. The term creditor includes a creditor's assignee, transferee, or subrogee who so participates. For purposes of §§1002.4(a) and (b), the term creditor also includes a person who, in the ordinary course of business, regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made. A person is not a creditor regarding any violation of the Act or this part committed by another creditor unless the person knew or had reasonable notice of the act, policy, or practice that constituted the violation before becoming involved in the credit transaction. The term does not include a person whose only participation in a credit transaction involves honoring a credit card.

Regulatory Commentary

2(l) Creditor.

*1. **Assignees.** The term creditor includes all persons participating in the credit decision. This may include an assignee or a potential purchaser of the obligation who influences the credit decision by indicating whether or not it will purchase the obligation if the transaction is consummated.*

*2. **Referrals to creditors.** For certain purposes, the term creditor includes persons such as real estate brokers, automobile dealers, home builders, and home-improvement contractors who do not participate in credit decisions but who only accept applications and refer applicants to creditors, or select or offer to select creditors to whom credit requests can be made. These persons must comply with §1002.4(a), the general rule prohibiting discrimination, and with §1002.4(b), the general rule against discouraging applications.*

Credit Transaction - 12 CFR § 1002.2(m)

Regulatory Text

(m) **Credit transaction** means every aspect of an applicant's dealings with a creditor regarding an application for credit or an existing extension of credit (including, but not limited to, information requirements; investigation procedures; standards of creditworthiness; terms of credit; furnishing of credit information; revocation, alteration, or termination of credit; and collection procedures).

Regulatory Commentary

None.

Discriminate Against an Applicant - 12 CFR § 1002.2(n)

Regulatory Text

(n) **Discriminate against an applicant** means to treat an applicant less favorably than other applicants.

Regulatory Commentary

None.

Elderly - 12 CFR § 1002.2(o)

Regulatory Text

(o) **Elderly** means age 62 or older.

Regulatory Commentary

None.

Empirically Derived and Other Credit Scoring Systems - 12 CFR § 1002.2(p)

Regulatory Text

(p) **Empirically derived and other credit scoring systems**

(1) ***A credit scoring system*** is a system that evaluates an applicant's creditworthiness mechanically, based on key attributes of the applicant and aspects of the transaction, and that determines, alone or in conjunction with an evaluation of additional information about the applicant, whether an applicant is deemed creditworthy. To qualify as an ***empirically derived, demonstrably and statistically sound, credit scoring system,*** the system must be:

(i) Based on data that are derived from an empirical comparison of sample groups or the population of creditworthy and non-creditworthy applicants who applied for credit within a reasonable preceding period of time;

(ii) Developed for the purpose of evaluating the creditworthiness of applicants with respect to the legitimate business interests of the creditor utilizing the system (including, but not limited to, minimizing bad debt losses and operating expenses in accordance with the creditor's business judgment);

(iii) Developed and validated using accepted statistical principles and methodology; and

(iv) Periodically revalidated by the use of appropriate statistical principles and methodology and adjusted as necessary to maintain predictive ability.

(2) A creditor may use an empirically derived, demonstrably and statistically sound, credit scoring system obtained from another person or may obtain credit experience from which to develop such a system. Any such system must satisfy the criteria set forth in paragraph (p)(1)(i) through (iv) of this section; if the creditor is unable during the development process to validate the system based on its own credit experience in accordance with paragraph (p)(1) of this section, the system must be validated when sufficient credit experience becomes available. A system that fails this validity test is no longer an empirically derived, demonstrably and statistically sound, credit scoring system for that creditor.

Regulatory Commentary

2(p) Empirically derived and other credit scoring systems.

1. ***Purpose of definition.*** *The definition under §§1002.2(p)(1)(i) through (iv) sets the criteria that a credit system must meet in order to use age as a predictive factor. Credit systems that do not meet these criteria are judgmental systems and may consider age only for the purpose of determining a "pertinent element of creditworthiness." (Both types of systems may favor an elderly applicant. See §1002.6(b)(2).)*

2. ***Periodic revalidation.*** *The regulation does not specify how often credit scoring systems must be revalidated. The credit scoring system must be revalidated frequently enough to ensure that it continues to meet recognized professional statistical standards for statistical soundness. To ensure that predictive ability is being maintained, the creditor must periodically review the performance of the system. This could be done, for example, by analyzing the loan portfolio to determine the delinquency rate for each score interval, or by analyzing population stability over time to detect deviations of recent applications from the applicant population used to validate the system. If this analysis indicates that the system no longer predicts risk with statistical soundness, the system must be adjusted as necessary to reestablish its predictive ability. A creditor is responsible for ensuring its system is validated and revalidated based on the creditor's own data.*

3. ***Pooled data scoring systems.*** *A scoring system or the data from which to develop such a system may be obtained from either a single credit grantor or multiple credit grantors. The resulting system will qualify as an empirically derived, demonstrably and statistically sound, credit scoring system provided the criteria set forth in paragraph (p)(1)(i) through (iv) of this section are met. A creditor is responsible for ensuring its system is validated and revalidated based on the creditor's own data when it becomes available.*

4. ***Effects test and disparate treatment.*** *An empirically derived, demonstrably and statistically sound, credit scoring system may include age as a predictive factor (provided that the age of an elderly applicant is not assigned a negative factor or value). Besides age, no*

other prohibited basis may be used as a variable. Generally, credit scoring systems treat all applicants objectively and thus avoid problems of disparate treatment. In cases where a credit scoring system is used in conjunction with individual discretion, disparate treatment could conceivably occur in the evaluation process. In addition, neutral factors used in credit scoring systems could nonetheless be subject to challenge under the effects test. (See comment 6(a)-2 for a discussion of the effects test).

Extend Credit and Extension of Credit - 12 CFR § 1002.2(q)

Regulatory Text

(q) **Extend credit and extension of credit** mean the granting of credit in any form (including, but not limited to, credit granted in addition to any existing credit or credit limit; credit granted pursuant to an open-end credit plan; the refinancing or other renewal of credit, including the issuance of a new credit card in place of an expiring credit card or in substitution for an existing credit card; the consolidation of two or more obligations; or the continuance of existing credit without any special effort to collect at or after maturity).

Regulatory Commentary

None.

Good Faith - 12 CFR § 1002.2(r)

Regulatory Text

(r) **Good faith** means honesty in fact in the conduct or transaction.

Regulatory Commentary

None.

Inadvertent Error - 12 CFR § 1002.2(s)

Regulatory Text

(s) **Inadvertent error** means a mechanical, electronic, or clerical error that a creditor demonstrates was not intentional and occurred notwithstanding the maintenance of procedures reasonably adapted to avoid such errors.

Regulatory Commentary

None.

Judgmental System of Evaluating Applicants - 12 CFR § 1002.2(t)

Regulatory Text

(t) **Judgmental system of evaluating applicants** means any system for evaluating the creditworthiness of an applicant other than an empirically derived, demonstrably and statistically sound, credit scoring system.

Regulatory Commentary

None.

Marital Status - 12 CFR § 1002.2(u)

Regulatory Text

(u) **Marital status** means the state of being unmarried, married, or separated, as defined by applicable state law. The term "unmarried" includes persons who are single, divorced, or widowed.

Regulatory Commentary

None.

Negative Factor or Value - 12 CFR § 1002.2(v)

Regulatory Text

(v) **Negative factor or value,** in relation to the age of elderly applicants, means utilizing a factor, value, or weight that is less favorable regarding elderly applicants than the creditor's experience warrants or is less favorable than the factor, value, or weight assigned to the class of applicants that are not classified as elderly and are most favored by a creditor on the basis of age.

Regulatory Commentary

None.

Open-End Credit - 12 CFR § 1002.2(w)

Omitted.

Person - 12 CFR § 1002.2(x)

Regulatory Text

(x) **Person** means a natural person, corporation, government or governmental subdivision or agency, trust, estate, partnership, cooperative, or association.

Regulatory Commentary

None.

Pertinent Element of Creditworthiness - 12 CFR § 1002.2(y)

Regulatory Text

(y) **Pertinent element of creditworthiness,** in relation to a judgmental system of evaluating applicants, means any information about applicants that a creditor obtains and considers and that has a demonstrable relationship to a determination of creditworthiness.

Regulatory Commentary

None.

Prohibited Basis - 12 CFR § 1002.2(z)

Regulatory Text

(z) **Prohibited basis** means race, color, religion, national origin, sex, marital status, or age (provided that the applicant has the capacity to enter into a binding contract); the fact that all or part of the applicant's income derives from any public assistance program; or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act or any state law upon which an exemption has been granted by the Bureau.

Regulatory Commentary

2(z) Prohibited basis.

1. ***Persons associated with applicant.*** *As used in this part, prohibited basis refers not only to characteristics - the race, color, religion, national origin, sex, marital status, or age—of an applicant (or officers of an applicant in the case of a corporation) but also to the characteristics of individuals with whom an applicant is affiliated or with whom the applicant associates. This means, for example, that under the general rule stated in §1002.4(a), a creditor may not discriminate against an applicant because of that person's personal or business dealings with members of a certain religion, because of the national origin of any persons associated with the extension of credit (such as the tenants in the apartment complex being financed), or because of the race of other residents in the neighborhood where the property offered as collateral is located.*

2. ***National origin.*** *A creditor may not refuse to grant credit because an applicant comes from a particular country but may take the applicant's immigration status into account. A creditor may also take into account any applicable law, regulation, or executive order restricting dealings with citizens (or the government) of a particular country or imposing limitations regarding credit extended for their use.*

3. ***Public assistance program.*** *Any Federal, state, or local governmental assistance program that provides a continuing, periodic income supplement, whether premised on entitlement or need, is "public assistance" for purposes of the regulation. The term includes (but is not limited to) Temporary Aid to Needy Families, food stamps, rent and mortgage supplement or assistance programs, social security and supplemental security income, and unemployment compensation. Only physicians, hospitals, and others to whom the benefits are payable need consider Medicare and Medicaid as public assistance.*

State - 12 CFR § 1002.2(aa)

Omitted.

Interagency Fair Lending Exam Procedures

Introduction

Section 1: Fair Lending Examination Procedures Introduction

Lending Discrimination Statutes and Regulations

The Equal Credit Opportunity Act (ECOA) prohibits discrimination in any aspect of a credit transaction. It applies to any extension of credit, including extensions of credit to small businesses, corporations, partnerships, and trusts.

The ECOA prohibits discrimination based on:

- Race or color;
- Religion;
- National origin;
- Sex;
- Marital status;
- Age (provided the applicant has the capacity to contract);
- The applicant's receipt of income derived from any public assistance program; or
- The applicant's exercise, in good faith, of any right under the Consumer Credit Protection Act.

The Consumer Financial Protection Bureau's Regulation B, found at 12 CFR part 1002, implements the ECOA. Regulation B describes lending acts and practices that are specifically prohibited, permitted, or required. Official staff interpretations of the regulation are found in Supplement I to 12 CFR part 1002.

The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 further amended the ECOA and covers:

- Data collection for loans to minority-owned and women-owned businesses (awaiting final regulation);
- Legal action statute of limitations for ECOA violations is extended to five years (effective July 21, 2010); and
- A disclosure of the consumer's ability to receive a copy of any appraisal(s) and valuation(s) prepared in connection with first-lien loans secured by a dwelling is to be provided to applicants within 3 business days of receiving the application (effective January 18, 2014).

The Fair Housing Act (FHAct) prohibits discrimination in all aspects of "residential real-estate related transactions," including but not limited to:

- Making loans to buy, build, repair, or improve a dwelling;
- Purchasing real estate loans;
- Selling, brokering, or appraising residential real estate; or

- Selling or renting a dwelling.

The FHAct prohibits discrimination based on:

- Race or color;
- National origin;
- Religion;
- Sex;
- Familial status (defined as children under the age of 18 living with a parent or legal custodian, pregnant women, and people securing custody of children under 18); or
- Handicap.

The Department of Housing and Urban Development's (HUD) regulations implementing the FHAct are found at 24 CFR Part 100. Because both the FHAct and the ECOA apply to mortgage lending, lenders may not discriminate in mortgage lending based on any of the prohibited factors in either list.

Under the ECOA, it is unlawful for a lender to discriminate on a prohibited basis in any aspect of a credit transaction, and under both the ECOA and the FHAct, it is unlawful for a lender to discriminate on a prohibited basis in a residential real-estate-related transaction. Under one or both of these laws, a lender may not, because of a prohibited factor:

- Fail to provide information or services or provide different information or services regarding any aspect of the lending process, including credit availability, application procedures, or lending standards.
- Discourage or selectively encourage applicants with respect to inquiries about or applications for credit.
- Refuse to extend credit or use different standards in determining whether to extend credit.
- Vary the terms of credit offered, including the amount, interest rate, duration, or type of loan.
- Use different standards to evaluate collateral.
- Treat a borrower differently in servicing a loan or invoking default remedies.
- Use different standards for pooling or packaging a loan in the secondarymarket.

A lender may not express, orally or in writing, a preference based on prohibited factors or indicate that it will treat applicants differently on a prohibited basis. A violation may still exist even if a lender treated applicants equally.

A lender may not discriminate on a prohibited basis because of the characteristics of

- An applicant, prospective applicant, or borrower.
- A person associated with an applicant, prospective applicant, or borrower (for example, a co-applicant, spouse, business partner, or live-in aide).

- The present or prospective occupants of either the property to be financed or the characteristics of the neighborhood or other area where property to be financed is located.

Finally, the FHAct requires lenders to make reasonable accommodations for a person with disabilities when such accommodations are necessary to afford the person an equal opportunity to apply for credit.

Section 2: Types of Lending Discrimination

Introduction

The courts have recognized three methods of proof of lending discrimination under the ECOA and the Fair Housing Act:

- Overt evidence of disparate treatment;
- Comparative evidence of disparate treatment; and
- Evidence of disparate impact.

Disparate Treatment

The existence of illegal disparate treatment may be established either by statements revealing that a lender explicitly considered prohibited factors (overt evidence) or by differences in treatment that are not fully explained by legitimate nondiscriminatory factors (comparative evidence).

Overt Evidence of Disparate Treatment. There is overt evidence of discrimination when a lender openly discriminates on a prohibited basis.

Example: A lender offered a credit card with a limit of up to $750 for applicants aged 21-30 and $1500 for applicants over 30. This policy violated the ECOA's prohibition on discrimination based on age.

There is overt evidence of discrimination even when a lender expresses — but does not act on— a discriminatory preference:

Example: A lending officer told a customer, "We do not like to make home mortgages to Native Americans, but the law says we cannot discriminate and we have to comply with the law." This statement violated the FHAct's prohibition on statements expressing a discriminatory preference as well as Section 1002.4(b) of Regulation B, which prohibits discouraging applicants on a prohibited basis.

Comparative Evidence of Disparate Treatment. Disparate treatment occurs when a lender treats a credit applicant differently based on one of the prohibited bases. It does not require any showing that the treatment was motivated by prejudice or a conscious intention to discriminate against a person beyond the difference in treatment itself.

Disparate treatment may more likely occur in the treatment of applicants who are neither clearly well-qualified nor clearly unqualified. Discrimination may more readily affect applicants in this middle group for two reasons. First, if the applications are "close cases," there is more room and need for lender discretion. Second, whether or not an applicant qualifies may depend on the level of assistance the lender provides the applicant in completing an application. The lender may, for example, propose solutions to credit or other problems regarding an application, identify compensating factors, and provide encouragement to the applicant. Lenders are under no obligation to provide such assistance, but to the extent that they do, the assistance must be provided in a nondiscriminatory way.

Example: A non-minority couple applied for an automobile loan. The lender found adverse information in the couple's credit report. The lender discussed the credit report with them and determined that the adverse information, a judgment against the couple, was incorrect because the judgment had been vacated. The non-minority couple was granted their loan. A minority couple applied for a similar loan with the same lender. Upon discovering adverse information in the minority couple's credit report, the lender denied the loan application on the basis of the adverse information without giving the couple an opportunity to discuss the report.

The foregoing is an example of disparate treatment of similarly situated applicants, apparently based on a prohibited factor, in the amount of assistance and information the lender provided.

If a lender has apparently treated similar applicants differently on the basis of a prohibited factor, it must provide an explanation for the difference in treatment. If the lender's explanation is found to be not credible, the agency may find that the lender discriminated.

Redlining is a form of illegal disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located. Redlining may violate both the FHAct and the ECOA.

Disparate Impact

When a lender applies a racially or otherwise neutral policy or practice equally to all credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis, the policy or practice is described as having a "disparate impact."

Example: A lender's policy is not to extend loans for single family residences for less than $60,000.00. This policy has been in effect for ten years. This minimum loan amount policy is shown to disproportionately exclude potential minority applicants from consideration because of their income levels or the value of the houses in the areas in which they live.

The fact that a policy or practice creates a disparity on a prohibited basis is not alone proof of a violation. When an Agency finds that a lender's policy or practice has a disparate impact; the next step is to seek to determine whether the policy or practice is justified by "business necessity." The justification must be manifest and may not be hypothetical or speculative.

Factors that may be relevant to the justification could include cost and profitability. Even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it still may be found to be in violation if an alternative policy or practice could serve the same purpose with less discriminatory effect. Finally, evidence of discriminatory intent is not necessary to establish that a lender's adoption or implementation of a policy or practice that has a disparate impact is in violation of the FHAct or ECOA.

These procedures do not call for examiners to plan examinations to identify or focus on potential disparate impact issues. The guidance in this Introduction is intended to help examiners recognize fair lending issues that may have a potential disparate impact. Guidance in the **Appendix** to the Interagency Fair Lending Examination Procedures provides details on how to obtain relevant information regarding such situations along with methods of evaluation, as appropriate.

General Guidelines

These procedures are intended to be a basic and flexible framework to be used in the majority of fair lending examinations conducted by the FFIEC agencies. They are also intended to guide examiner judgment, not to supplant it. The procedures can be augmented by each agency as necessary to ensure their effective implementation. While these procedures apply to many examinations, agencies routinely use statistical analyses or other specialized techniques in fair lending examinations to assist in evaluating whether a prohibited basis was a factor in an institution's credit decisions. Examiners should follow the procedures provided by their respective agencies in these cases. For a number of aspects of lending — for example, credit scoring and loan pricing — the "state of the art" is more likely to be advanced if the agencies have some latitude to incorporate promising innovations. These interagency procedures provide for that latitude. Any references in these procedures to options, judgment, etc., of "examiners" means discretion within the limits provided by that examiner's agency. An examiner should use these procedures in conjunction with his, or her, own agency's priorities, examination philosophy, and detailed guidance for implementing these procedures. These procedures should not be interpreted as providing the examiner greater latitude than his, or her, own agency would. For example, if an agency's policy is to review compliance management systems in all of its institutions, an examiner for that agency must conduct such a review rather than interpret Part II of these interagency procedures as leaving the review to the examiner's option. The procedures emphasize racial and national origin discrimination in residential transactions, but the key principles are applicable to other prohibited bases and to nonresidential transactions. Finally, these procedures focus on analyzing institution compliance with the broad, nondiscrimination requirements of the ECOA and the FHAct. They do not address such explicit or technical compliance provisions as the signature rules or adverse action notice requirements in Sections 1002.7 and 1002.9, respectively, of Regulation B.

Interagency Fair Lending Examination Procedures

The procedure text (abridged) appears in this manual.

Section 1: Part One: Examination Scope Guidelines

Background

The FDIC has developed the Fair Lending Scope and Conclusions Memorandum (FLSC) to implement a standard nationwide format for documenting the scope and conclusions of fair lending reviews. FLSC has been adopted as a means of focusing the examiner's attention to the areas that pose the greatest unmanaged fair lending risk to the institution. It incorporates the Interagency Fair Lending Examination Procedures and assists in documenting the types of fair lending risks that are present; the controls that management has put in place to manage the risk; the effectiveness of these controls; why the particular focal point(s) are chosen; the level of review conducted; and the results of any additional analysis that was conducted.

The scope of an examination encompasses the loan product(s), market(s), decision center(s), time frame, and prohibited basis and control group(s) to be analyzed during the examination. These procedures refer to each potential combination of those elements as a "focal point." Setting the scope of an examination involves, first, identifying all of the potential focal points that appear worthwhile to examine. Then, from among those, examiners select the **Focal Point(s)** that will form the scope of the examination, based on risk factors, priorities established in these procedures or by their respective agencies, the record from past examinations, and other relevant guidance. This phase includes obtaining an overview of an institution's compliance management system as it relates to fair lending.

When selecting focal points for review, examiners may determine that the institution has performed "self-tests" or "self-evaluations" related to specific lending products. The difference between "self-tests" and "self-evaluations" is discussed in the *Using Self-Tests and Self-Evaluations to Streamline the Examination* section of the **Appendix**. Institutions must share all information regarding "self- evaluations" and certain limited information related to "self- tests." Institutions may choose to voluntarily disclose additional information about "self-tests." Examiners should make sure that institutions understand that voluntarily sharing the results of self-tests will result in a loss of confidential status of these tests. Information from "self-evaluations" or "self-tests" may allow the scoping to be streamlined. Refer to *Using Self-Tests and Self-Evaluations to Streamline the Examination* in the **Appendix** for additional details.

Scoping may disclose the existence of circumstances - such as the use of credit scoring or a large volume of residential lending - which, under an agency's policy, call for the use of regression analysis or other statistical methods of identifying potential discrimination with respect to one or more loan products. Where that is the case, the agency's specialized procedures should be employed for such loan products rather than the procedures set forth below.

Setting the intensity of an examination means determining the breadth and depth of the analysis that will be conducted on the selected loan product(s). This process entails a more involved analysis of the institution's compliance risk management processes, particularly as it relates to selected products, to reach an informed decision regarding how large a sample of files to review in any transactional analyses performed and whether certain aspects of the credit process deserve heightened scrutiny.

Part I of these procedures provides guidance on establishing the scope of the examination. Part II (Compliance Management Review) provides guidance on determining the intensity of the examination. There is naturally some interdependence between these two phases. Ultimately the scope and intensity of the examination will determine the record of performance that serves as the foundation for agency conclusions about institutional compliance with fair lending obligations. The examiner should employ these procedures to arrive at a well-reasoned and practical conclusion about how to conduct a particular institution's examination of fair lending performance.

In certain cases where an agency already possesses information which provides examiners with guidance on priorities and risks for planning an upcoming examination, such information may expedite the scoping process and make it unnecessary to carry out all of the steps below. For example, the report of the previous fair lending examination may have included recommendations for the focus of the next examination. However, examiners should validate that the institution's operational structure, product offerings, policies, and risks have not changed since the prior examination before condensing the scoping process.

The scoping process can be performed either off-site, onsite, or both, depending on whatever is determined appropriate and feasible. In the interest of minimizing burdens on both the examination team and the institution, requests for information from the institution should be carefully thought out so as to include only the information that will clearly be useful in the examination process. Finally, any off-site information requests should be made sufficiently in advance of the on-site schedule to permit institutions adequate time to assemble necessary information and provide it to the examination team in a timely fashion. (*See* "**Potential Scoping Information**" in the **Appendix** for guidance on additional information that the examiner might wish to consider including in a request).

Examiners should focus the examination based on:

- An understanding of the credit operations of the institution;
- The risk that discriminatory conduct may occur in each area of those operations; and
- The feasibility of developing a factually reliable record of an institution's performance and fair lending compliance in each area of those operations.

Understanding Credit Operations

Before evaluating the potential for discriminatory conduct, the examiner should review sufficient information about the institution and its market to understand the credit operations of the institution and the representation of prohibited basis group residents within the markets where the institution does business. The level of detail to be obtained at this stage should be sufficient to identify whether any of the risk factors in the steps below are present. Relevant background information includes:

- The types and terms of credit products offered, differentiating among broad categories of credit such as residential, consumer, or commercial, as well as product variations within such categories (fixed vs. variable, etc.).
- Whether the institution has a special purpose credit program, or other program that is specifically designed to assist certain underserved populations.

- The volume of, or growth in, lending for each of the credit products offered.
- The demographics (i.e., race, national origin, etc.) of the credit markets in which the institution is doing business.
- The institution's organization of its credit decision-making process, including identification of the delegation of separate lending authorities and the extent to which discretion in pricing or setting credit terms and conditions is delegated to various levels of managers, employees or independent brokers or dealers.
- The institution's loan officer or broker compensation program.
- The types of relevant documentation/data that are available for various loan products and what is the relative quantity, quality and accessibility of such information (i.e., for which loan product(s) will the information available be most likely to support a sound and reliable fair lending analysis).
- The extent to which information requests can be readily organized and coordinated with other compliance examination components to reduce undue burden on the institution. (Do not request more information than the exam team can be expected to utilize during the anticipated course of the examination.)

In thinking about an institution's credit markets, the examiner should recognize that these markets may or may not coincide with an institution's Community Reinvestment Act (CRA) assessment area(s). Where appropriate, the examiner should review the demographics for a broader geographic area than the assessment area.

Where an institution has multiple underwriting or loan processing centers or subsidiaries, each with fully independent credit-granting authority, consider evaluating each center and/or subsidiary separately, provided a sufficient number of loans exist to support a meaningful analysis. In determining the scope of the examination for such institutions, examiners should consider whether:

- Subsidiaries should be examined. The agencies will hold a financial institution responsible for violations by its direct subsidiaries, but not typically for those by its affiliates (unless the affiliate has acted as the agent for the institution or the violation by the affiliate was known or should have been known to the institution before it became involved in the transaction or purchased the affiliate's loans). When seeking to determine an institution's relationship with affiliates that are not supervised financial institutions, limit the inquiry to what can be learned in the institution and do not contact the affiliate without prior consultation with agency staff.
- The underwriting standards and procedures used in the entity being reviewed are used in related entities not scheduled for the planned examination. This will help examiners to recognize the potential scope of policy-based violations.
- The portfolio consists of applications from a purchased institution. If so, for scoping purposes, examiners should consider the applications as if they were made to the purchasing institution. *For comparison purposes, applications evaluated under the purchased institution's standards should not be compared to applications evaluated under the purchasing institution's standards.*

- The portfolio includes purchased loans. If so, examiners should look for indications that the institution specified loans to purchase based on a prohibited factor or caused a prohibited factor to influence the origination process.
- A complete decision can be made at one of the several underwriting or loan processing centers, each with independent authority. In such a situation, it is best to conduct on-site a separate comparative analysis at each underwriting center. If covering multiple centers is not feasible during the planned examination, examiners should review their processes and internal controls to determine whether or not expanding the scope and/or length of the examination is justified.
- Decision-making responsibility for a single transaction may involve more than one underwriting center. For example, an institution may have authority to decline mortgage applicants, but only the mortgage company subsidiary may approve them. In such a situation, examiners should learn which standards are applied in each entity and the location of records needed for the planned comparisons.
- Applicants can be steered from the financial institution to the subsidiary or other lending channel and vice versa, and what policies and procedures exist to monitor this practice.
- Any third parties, such as brokers or contractors, are involved in the credit decision and how responsibility is allocated among them and the institution. The institution's familiarity with third party actions may be important, for an institution may be in violation if it participates in transactions in which it knew or reasonably ought to have known other parties were discriminating.

As part of understanding the financial institution's own lending operations, it is also important to understand any dealings the financial institution has with affiliated and non-affiliated mortgage loan brokers and other third party lenders.

These brokers may generate mortgage applications and originations solely for a specific financial institution or may broadly gather loan applications for a variety of local, regional, or national lenders. As a result, it is important to recognize what impact these mortgage brokers and other third party lender actions and application processing operations have on the lending operations of a financial institution. Because brokers can be located anywhere in or out of the financial institution's primary lending or CRA assessment areas, it is important to evaluate broker activity and fair lending compliance related to underwriting, terms, and conditions, redlining, and steering, each of which is covered in more depth in sections of these procedures. Examiners should consult with their respective agencies for specific guidance regarding broker activity.

If the institution is large and geographically diverse, examiners should select only as many markets or underwriting centers as can be reviewed readily in depth, rather than selecting proportionally to cover every market. As needed, examiners should narrow the focus to the Metropolitan Statistical Area (MSA) or underwriting center(s) that are determined to present the highest discrimination risk. Examiners should use Loan Application Register (LAR) data organized by underwriting center, if available. After calculating denial rates between the control and prohibited basis groups for the underwriting centers, examiners should select the centers with the highest fair lending risk. This approach would also be used when reviewing pricing or other terms and conditions of approved applicants from the prohibited basis and control groups. If underwriting centers have fewer than five racial or national origin denials, examiners should not examine for racial discrimination in underwriting. Instead, they should shift the focus to other loan products or prohibited bases, or examination types such as a pricing examination.

However, if examiners learn of other indications of risks that favor analyzing a prohibited basis with fewer transactions than the minimum in the sample size tables, they should consult with their supervisory office on possible alternative methods of analysis. For example, there is strong reason to examine a pattern in which almost all of 19 male borrowers received low rates but almost all of four female borrowers received high rates, even though the number of each group is fewer than the stated minimum. Similarly, there would be strong reason to examine a pattern in which almost all of 100 control group applicants were approved but all four prohibited basis group applicants were not, even though the number of prohibited basis denials was fewer than five.

Evaluating the Potential for Discriminatory Conduct

Step One: Develop an Overview

Based on his or her understanding of the credit operations and product offerings of an institution, an examiner should determine the nature and amount of information required for the scoping process and should obtain and organize that information. No single examination can reasonably be expected to evaluate compliance performance as to every prohibited basis, in every product, or in every underwriting center or subsidiary of an institution. In addition to information gained in the process of Understanding Credit Operations, above, the examiner should keep in mind the following factors when selecting products for the scoping review:

- Which products and prohibited bases were reviewed during the most recent prior examination(s) and, conversely, which products and prohibited bases have not recently been reviewed?
- Which prohibited basis groups make up a significant portion of the institution's market for the different credit products offered?
- Which products and prohibited basis groups the institution reviewed using either a voluntarily disclosed self-test or a self-evaluation?

Based on consideration of the foregoing factors, the examiner should request information for all residential and other loan products considered appropriate for scoping in the current examination cycle. In addition, wherever feasible, examiners should conduct preliminary interviews with the institution's key underwriting personnel and those involved with establishing the institution's pricing policies and practices. Using the accumulated information, the examiner should evaluate the following, as applicable:

- Underwriting guidelines, policies, and standards.
- Descriptions of credit scoring systems, including a list of factors scored, cutoff scores, extent of validation, and any guidance for handling overrides and exceptions. (Refer to Part A of the "Considering Automated Underwriting and Credit Scoring" section of the **Appendix** for guidance.)
- Applicable pricing policies, risk-based pricing models, and guidance for exercising discretion over loan terms and conditions.

- Descriptions of any compensation system, including whether compensation is related to, loan production or pricing.
- The institution's formal and informal relationships with any finance companies, subprime mortgage or consumer lending entities, or similar institutions.
- Loan application forms.
- Home Mortgage Disclosure Act – Loan Application Register (HMDA-LAR) or loan registers and lists of declined applications.
- Description(s) of databases maintained for loan product(s) to be reviewed.
- Records detailing policy exceptions or overrides, exception reporting and monitoring processes.
- Copies of any consumer complaints alleging discrimination and related loan files.
- Compliance program materials (particularly fair lending policies), training manuals, organization charts, as well as record keeping, monitoring protocols, and internal controls.
- Copies of any available marketing materials or descriptions of current or previous marketing plans or programs or pre-screened solicitations.

Step Two: Identify Compliance Program Discrimination Risk Factors

Review information from agency examination work papers, institutional records and any available discussions with management representatives in sufficient detail to understand the organization, staffing, training, recordkeeping, auditing, policies and procedures of the institution's fair lending compliance systems. Review these systems and note the following risk factors:

C1. Overall institution compliance record is weak.

C2. Prohibited basis monitoring information required by applicable laws and regulations is nonexistent or incomplete.

C3. Data and/or recordkeeping problems compromised reliability of previous examination reviews.

C4. Fair lending problems were previously found in one or more institution products or in institution subsidiaries.

C5. The size, scope, and quality of the compliance management program, including senior management's involvement, designation of a compliance officer, and staffing is materially inferior to programs customarily found in institutions of similar size, market demographics, and credit complexity.

C6. The institution has not updated compliance policies and procedures to reflect changes in law or in agency guidance.

C7. Fair lending training is nonexistent or weak.

Consider these risk factors and their impact on particular lending products and practices as you conduct the product specific risk review during the scoping steps that follow. Where this review identifies fair lending compliance system deficiencies, give them appropriate consideration as part of the Compliance Management Review in Part II of these procedures.

Step Three: Review Residential Loan Products

Although home mortgages may not be the ultimate subject of every fair lending examination, this product line must at least be considered in the course of scoping every institution that is engaged in the residential lending market.

Divide home mortgage loans into the following groupings: home purchase, home improvement, and refinancings. Subdivide those three groups further if an institution does a significant number of any of the following types or forms of residential lending, and consider them separately:

- Government-insured loans
- Mobile home or manufactured housing loans
- Wholesale, indirect, and brokered loans
- Portfolio lending (including portfolios of Fannie Mae/Freddie Mac rejections)

In addition, determine whether the institution offers any conventional "affordable" housing loan programs special purpose credit programs or other programs that are specifically designed to assist certain borrowers, such as underserved populations and whether their terms and conditions make them incompatible with regular conventional loans for comparative purposes. If so, consider them separately.

If previous examinations have demonstrated the following, then an examiner may limit the focus of the current examination to alternative underwriting or processing centers or to other residential products that have received less scrutiny in the past:

- A strong fair lending compliance program.
- No record of discriminatory transactions at particular decision centers or in particular residential products.
- No indication of a significant change in personnel, operations, or underwriting or pricing policies at those centers or in those residential products.
- No unresolved fair lending complaints, administrative proceedings, litigation, or similar factors.
- No discretion to set price or credit terms and conditions in particular decision centers or for particular residential products.

Step Four: Identify Residential Lending Discrimination Risk Factors

Review the lending policies, marketing plans, underwriting, appraisal and pricing guidelines, broker/agent agreements and loan application forms for each residential loan product that represents an appreciable volume of, or displays noticeable growth in, the institution's residential lending.

- Review also any available data regarding the geographic distribution of the institution's loan originations with respect to the race and national origin percentages of the census tracts within its assessment area or, if different, its residential loan product lending area(s).
- Conduct interviews of loan officers and other employees or agents in the residential lending process concerning adherence to and understanding of the above policies and guidelines as well as any relevant operating practices.
- In the course of conducting the foregoing inquiries, look for the following risk factors (factors are numbered alphanumerically to coincide with the type of factor, e.g., "O" for "overt"; "P" for "pricing," etc.).

***NOTE**: For risk factors below that are marked with an asterisk (*), examiners need not attempt to calculate the indicated ratios for racial or national origin characteristics when the institution is not a HMDA reporter. However, consideration should be given in such cases to whether or not such calculations should be made based on gender or racial-ethnic surrogates.*

***Overt** indicators of discrimination such as:*

O1. Including explicit prohibited basis identifiers in the institution's written or oral policies and procedures (underwriting criteria, pricing standards, etc.).

O2. Collecting information, conducting inquiries or imposing conditions contrary to express requirements of Regulation B.

O3. Including variables in a credit scoring system that constitute a basis or factor prohibited by Regulation B or, for residential loan scoring systems, the FHAct. (If a credit scoring system scores age, refer to *Part E* of the *Considering Automated Underwriting and Credit Scoring* section of the **Appendix**.)

O4. Statements made by the institution's officers, employees, or agents which constitute an express or implicit indication that one or more such persons have engaged or do engage in discrimination on a prohibited basis in any aspect of a credit transaction.

O5. Employee or institutional statements that evidence attitudes based on prohibited basis prejudices or stereotypes.

*Indicators of potential **disparate treatment in Underwriting** such as:*

U1. *Substantial disparities among the approval/denial rates for applicants by monitored prohibited basis characteristic (especially within income categories).

U2. *Substantial disparities among the application processing times for applicants by monitored prohibited basis characteristic (especially within denial reason groups).

U3. *Substantially higher proportion of withdrawn/ incomplete applications from prohibited basis group applicants than from other applicants.

U4. Vague or unduly subjective underwriting criteria.

U5. Lack of clear guidance on making exceptions to underwriting criteria, including credit scoring overrides.

U6. Lack of clear loan file documentation regarding reasons for any exceptions to standard underwriting criteria, including credit scoring overrides.

U7. Relatively high percentages of either exceptions to underwriting criteria or overrides of credit score cutoffs.

U8. Loan officer or broker compensation based on loan volume (especially loans approved per period of time).

U9. Consumer complaints alleging discrimination in loan processing or in approving/denying residential loans.

Indicators of potential ***disparate treatment in Pricing*** *(interest rates, fees, or points) such as:*

P1. Financial incentives for loan officers or brokers to charge higher prices (including interest rate, fees and points). Special attention should be given to situations where financial incentives are accompanied by broad pricing discretion (as in P2), such as through the use of overages or yield spread premiums.

P2. Presence of broad discretion in loan pricing (including interest rate, fees and points), such as through overages, underages or yield spread premiums. Such discretion may be present even when institutions provide rate sheets and fees schedules, if loan officers or brokers are permitted to deviate from those rates and fees without clear and objective criteria.**P3.** Use of risk-based pricing that is not based on objective criteria or applied consistently.

P4. *Substantial disparities among prices being quoted or charged to applicants who differ as to their monitored prohibited basis characteristics.

P5. Consumer complaints alleging discrimination in residential loan pricing.

P6. *In mortgage pricing, disparities in the incidence or rate spreads of higher-priced lending by prohibited basis characteristics as reported in the HMDA data.

P7. *A loan program that contains only borrowers from a prohibited basis group, or has significant differences in the percentages of prohibited basis groups, especially in the absence of a Special Purpose Credit Program under ECOA.

Indicators of potential ***disparate treatment by Steering*** *such as:*

Omitted from presentation.

Indicators of potential ***discriminatory Redlining*** *such as:*

Omitted from presentation.

Indicators of potential ***disparate treatment in Marketing*** *of residential products, such as:*

Omitted from presentation.

Step Five: Organize and Focus Residential Risk Analysis

Review the risk factors identified in Step 4 and, for each loan product that displays risk factors, articulate the possible discriminatory effects encountered and organize the examination of those loan products in accordance with the following guidance. For complex issues regarding these factors, consult with agency supervisory staff.

- Where overt evidence of discrimination, as described in factors O1-O5, has been found in connection with a product, document those findings as described in Part III, B, besides completing the remainder of the planned examination analysis.
- Where any of the risk factors U1-U9 are present, consider conducting an underwriting comparative file analysis as described in Part III, C.
- Where any of the risk factors P1-P7 are present, consider conducting a pricing comparative file analysis as described in Part III, D.
- Where any of the risk factors S1-S8 are present, consider conducting a steering analysis as described in Part III, E.
- Where any of the risk factors R1-R12 are present, consider conducting an analysis for redlining as described in Part III, G.
- Where any of the risk factors M1-M7 are present, consider conducting a marketing analysis as described in Part III, H.
- Where an institution uses age in any credit scoring system, consider conducting an examination analysis of that credit scoring system's compliance with the requirements of Regulation B as described in Part III, I.

Step Six: Identify Consumer Lending Discrimination Risk Factors

Omitted from presentation.

Step Seven: Identify Commercial Lending Discrimination Risk Factors

Omitted from presentation.

Step Eight: Complete the Scoping Process

To complete the scoping process, the examiner should review the results of the preceding steps and select those focal points that warrant examination, based on the relative risk levels identified above. In order to remain within the agency's resource allowances, the examiner may need to choose a smaller number of focal points from among all those selected on the basis of risk. In such instances, set the scope by first, prioritizing focal points on the basis of (i) high number and/or relative severity of risk factors; (ii) high data quality and other factors affecting the likelihood of obtaining reliable examination results; (iii) high loan volume and the likelihood of widespread risk to applicants and borrowers; and (iv) low quality of any compliance program and, second, selecting for examination review as many focal points as resources permit.

Where the judgment process among competing focal points is a close call, information learned in the phase of conducting the compliance management review can be used to further refine the examiner's choices.

Section 2: Compliance Management Review

Compliance Management Analysis Checklist

This checklist is for use in conjunction with Part II of these procedures as a device for examiners to evaluate the strength of an institution's compliance program in terms of its capacity to prevent, and to identify and self-correct fair lending violations in connection with the products or issues selected for analysis. The checklist is not intended to be an absolute test of an institution's compliance management program. Programs containing all or most of the features described in the list may nonetheless be flawed for other reasons; conversely, a compliance program that encompasses only a portion of the factors listed below may nonetheless adequately support a strong program under appropriate circumstances. In short, the examiner must exercise his or her best judgment in utilizing this list and in assessing the overall quality of an institution's efforts to ensure fair lending compliance.

If the transactions within the proposed scope are covered by a listed preventive measure, and the answer is ―Yes, check the box in the first column. You may then reduce the intensity (mainly the sample size) of the planned comparative file review to the degree that the preventive measures cover transactions within the proposed scope. Document your findings in sufficient detail to justify any resulting reduction in the intensity of the examination.

You are not required to learn whether preventive measures apply to specific products outside the proposed scope. However, if the information you have obtained shows that the measure is a general practice of the institution, and thus applies to all loan products, check the box in the second column in order to assist future examination planning.

A. Preventive Measures

Determine whether policies and procedures exist that tend to prevent illegal disparate treatment in the transactions you plan to examine. There is no legal or agency requirement for institutions to conduct these activities. The absence of any of these policies and practices is never, by itself, a violation.

Lending Practices and Standards:

Principal Policy Issues

- Are underwriting practices clear, objective, and generally consistent with industry standards?
- Is pricing within reasonably confined ranges with guidance linking variations to risk and/or cost factors?
- Does management monitor the nature and frequency of exceptions to its standards?
- Are denial reasons accurately and promptly communicated to unsuccessful applicants?
- Are there clear and objective standards for referring applicants to
    - o subsidiaries, affiliates, or other lending channels within the institution,

  - classifying applicants as prime or sub-prime borrowers, or
  - deciding what kinds of alternative loan products should be offered or recommended to applicants?
- Are loan officers required to document any deviation from the rate sheet?
- Does management monitor consumer complaints alleging discrimination in loan pricing or underwriting?
- Do training, application-processing aids, and other guidance correctly and adequately describe:
  - Prohibited bases under ECOA, Regulation B, and the Fair Housing Act?
  - Other substantive credit access requirements of Regulation B (e.g. spousal signatures, improper inquiries, protected income)?
- Is it specifically communicated to employees that they must not, on a prohibited basis:
  - Refuse to deal with individuals inquiring about credit?
  - Discourage inquiries or applicants by delays, discourtesy, or other means?
  - Provide different, incomplete, or misleading information about the
  - availability of loans,
  - application requirements, and
  - processing and approval standards or procedures (including selectively informing applicants about certain loan products while failing to inform them of alternatives)?
- Encourage or more vigorously assist only certain inquirers or applicants?
- Refer credit seekers to other institutions, more costly loan products, or potentially onerous features?
- Refer credit seekers to nontraditional products (i.e., negative amortization, interest only, payment option adjustable rate mortgages) when they could have qualified for traditional mortgages?
- Waive or grant exceptions to application procedures or credit standards?
- State a willingness to negotiate?
- Use different procedures or standards to evaluate applications?
- Use different procedures to obtain and evaluate appraisals?
- Provide certain applicants opportunities to correct or explain adverse or inadequate information, or to provide additional information?
- Accept alternative proofs of creditworthiness?

- Require co-signers?
- Offer or authorize loan modifications?
- Suggest or permit loan assumptions?
- Impose late charges, reinstatement fees, etc.?
- Initiate collection or foreclosure?
- Has the institution taken specific initiatives to prevent the following practices:
  - Basing credit decisions on assumptions derived from racial, gender, and other stereotypes, rather than facts?
  - Seeking consumers from a particular racial, ethnic, or religious group, or of a particular gender, to the exclusion of other types of consumers, on the basis of how comfortable the employee may feel in dealing with those different from him/her?
  - Limiting the exchange of credit-related information or the institution's efforts to qualify an applicant from a prohibited basis group.
  - Drawing the institution's CRA assessment area by unreasonably excluding minority areas?
  - Targeting certain borrowers or areas with less advantageous products?
- Does the institution have procedures to ensure that it does not:
  - State racial or ethnic limitations in advertisements?
  - Employ code words or use photos in advertisements that convey racial or ethnic limitations or preferences?
  - Place advertisement that a reasonable person would regard as indicating minority consumers are less desirable?
  - Advertise only in media serving predominantly minority or non-minority areas of the market?
  - Conduct other forms of marketing differentially in minority or non-minority areas of the market?
  - Market only through brokers known to serve only one racial or ethnic group in the market?
  - Use a prohibited basis in any pre-screened solicitation?
  - Provide financial incentives for loan officers to place applicants in nontraditional products or higher-risk products?
- Compliance Audit Function: Does the Institution Attempt to Detect Prohibited Disparate Treatment by Self-Test or Self-Evaluation?

NOTE: A self-test is any program, practice or study that is designed and specifically used to assess the institution's compliance with the ECOA and the Fair Housing Act. It creates data or factual information that is not otherwise available and cannot be derived from loan, application or other records related to credit transactions (12 C.F.R. 202.15(b)(1) and 24 C.F.R. 100.141). The report, results, and many other records associated with a self-test are privileged unless an institution voluntarily discloses the report or results or otherwise forfeits the privilege. See 12 C.F.R. 202.15(b)(2) and 24 C.F.R. 100.142(a) for a complete listing of the types of information covered by the privilege. A self-evaluation, while generally having the same purpose as a self-test, does not create any new data or factual information, but uses data readily available in loan or application files and other records used in credit transactions and, therefore, does not meet the self-test definition. See Using Self-Tests and Self-Evaluations to Streamline the Examination in this Appendix for more information about self-tests and self-evaluations.

While you may request the results of self-evaluations, you should not request the results of self-tests or any of the information listed in 12 C.F.R. 202.15(b)(2) and 24 C.F.R. 100.142(a). If an institution discloses the self-test report or results to its regulator, it will lose the privilege. The following items are intended to obtain information about the institution's approach to self-testing and self-evaluation, not the findings. Complete the checklist below for each self-evaluation and each self-test, where the institution voluntarily discloses the report or results. Evaluating the results of self-evaluations and voluntarily disclosed self-tests is described in Using Self-tests and Self-Evaluations to Streamline the Examination in this Appendix.

Are the transactions reviewed by an independent analyst who:

- Is directed to report objective results?
- Has an adequate level of expertise?
- Produces written conclusions?
- Does the institution's approach for self-testing or self-evaluation call for:
  - Attempting to explain major patterns shown in the HMDA or other loan data?
  - Determining whether actual practices and standards differ from stated ones and basing the evaluation on the actual practices?
  - Evaluating whether the reasons cited for denial are supported by facts relied on by the decision maker at the time of the decision?
  - Comparing the treatment of prohibited basis group applicants to control group applicants?
  - Obtaining explanations from decision makers for any unfavorable treatment of the prohibited basis group that departed from policy or customary practice?
- Covering significant decision points in the loan process where disparate treatment or discouragement might occur, including:
  - The approve/deny decision?
  - Pricing?

- Other terms and conditions?

- Covering at least as many transactions as examiners would independently, if using the Fair Lending Sample Size Tables for a product with the application volumes of the product to be evaluated?
- Maintaining information concerning personal characteristics collected as part of a self-test separately from application or loan files?
- Timely analysis of the data?
- Taking appropriate and timely corrective action?

In the institution's plan for comparing the treatment of prohibited basis group applicants with that of control group applicants:

- Are control and prohibited basis groups based on a prohibited basis found in ECOA or the FHAct and defined clearly to isolate that prohibited basis for analysis?
- Are appropriate data to be obtained to document treatment of applicants and the relative qualifications vis-à-vis the requirement in question?
- Will the data to be obtained reflect the data on which decisions were based?
- Does the plan call for comparing the denied applicants' qualifications related to the stated reason for denial with the corresponding qualifications for approved applicants?
- Are comparisons designed to identify instances in which prohibited basis group applicants were treated less favorably than control group applicants who were no better qualified?
- Is the evaluation designed to determine whether control and prohibited basis group applicants were treated differently in the processes by which the institution helped applicants overcome obstacles and by which their qualifications were enhanced?
- Are responses and explanations to be obtained for any apparent disparate treatment on a prohibited basis or other apparent violations of credit rights?
- Are reasons cited by credit decision makers to justify or explain instances of apparent disparate treatment to be verified?

For self-tests under ECOA that involved the collection of applicant personal characteristics, did the institution:

- develop a written plan that describes or identifies the:
  - specific purpose of the self-test?
  - methodology to be used?
  - geographic area(s) to be covered?
  - type(s) of credit transactions to be reviewed?
  - entity that will conduct the test and analyze the data?

- o timing of the test, including start and end dates or the duration of the self-test?
- o other related self-test data that is not privileged?
- o disclose at the time applicant characteristic information is requested, that:
- o the applicant will not be required to provide the information?
- o the creditor is requesting the information to monitor its compliance with ECOA?
- o federal law prohibits the creditor from discriminating on the basis of this information or on the basis of an applicant's decision not to furnish the information?
- o if applicable, certain information will be collected based on visual observation or surname if not provided by the applicant?

B. Corrective Measures

Determine whether the institution has provisions to take appropriate corrective action and provide adequate relief to victims for any violations in the transactions you plan to review. Who is to receive the results of a self-evaluation or voluntarily disclosed self-test? What decision process is supposed to follow delivery of the information? Is feedback to be given to staff whose actions are reviewed? What types of corrective action may occur? Are consumers to be:

- Offered credit if they were improperly denied?
- Compensated for any damages, both out of pocket and compensatory?
- Notified of their legal rights?
- Other corrective action:
  - o Are institutional policies or procedures that may have contributed to the discrimination to be corrected?
  - o Are employees involved to be trained and/or disciplined?
  - o Is the need for community outreach programs and/or changes in marketing strategy or loan products to better serve minority segments of the institution's market to be considered?
  - o Are audit and oversight systems to be improved in order to ensure there is not recurrence of any identified discrimination?

Fair Lending Focus Audit

Section 1: Young & Associates Suggested Techniques – Disparate Treatment

Introduction

This technique is included for those situations where a focus on fair lending in mortgage loans seems appropriate. It can be used for any type of loan, so we have included other loan types as well.

The concept here is very straightforward. To focus your review, determine those items where the staff is an agreement. If everyone agrees, the fair lending risk is lower. This technique will also point out those areas of disagreement. The areas of disagreement should be the primary subjects of your audit.

Lender Questionnaire

One way to test for disparate treatment is to develop a questionnaire to be completed by all lending personnel. The following is a list of sample questions that may be asked. The bank will typically pick only those questions which relate to how they do business. Additional questions may also be added.

Sample questions:

1. Please provide the credit criteria that you use to make consumer unsecured, consumer secured, and consumer real estate loans as follows:
    a. Front End Ratio (Housing to Income Ratio)
    b. Back End Ratio (Total Debt to Income Ratio)
    c. Loan to Value Ratio (without PMI)
    d. Length of Employment
    e. Length of Residency
    f. Minimum Credit Score
    g. Minimum Loan Amount
    h. Maximum Loan Amount
2. If a loan does not meet the criteria mentioned above, are there mitigating factors that are commonly used to determine potential approvals?
3. If the answer to question 2 was yes, please list them (i.e. high net worth, etc.):
4. How frequently are the considerations listed in question 3 used in a loan decision?

5. When these considerations are used to approve a loan, is the explanation documented in the file?

6. How do you determine the following:

   a. Interest rates

   b. Loan term

   c. Loan fees

   d. Other conditions of lending

7. How much flexibility do you have in determining the factors listed in question #6?

8. Can any rates or fees be negotiated?

9. Under what circumstances would a co-maker or guarantor be necessary?

10. How do you determine who the guarantor or co-maker should be?

11. For business credit, how do you determine who must sign on the loan?

12. Do you verify income for all customers? If no, what criteria do you use to determine whether you will verify income?

13. If applicable, what documentation do you use to verify income?

14. How many years on the job are required for income to be deemed stable?

15. How many years in the same line of work are required for income to be deemed stable?

16. Do you require an applicant to have a minimum amount of monthly income? If yes, how much?

17. When calculating the customer's debt to income ratios, do you exclude any types of income? If yes, please list the types of income and comment as to why they are excluded.

18. Do you gross up any type(s) of income? If so, which types and by what amount.

19. Would you deny a loan application when the only source of income is from child support? If yes, please explain.

20. Are there any credit obligations that would not be included in the debt to income ratio calculations? If yes, please explain.

21. How far into the past is derogatory information relevant?

22. If a customer has collections or other credit deficiencies, what percentage of the time do you request an explanation of the collections or deficiencies?

23. If you request an explanation, do you require it to be in writing? If the answer is yes, what percentage of the time do you assist in the preparation of the explanation?

24. Do you accept corrected information only from the credit reporting agency or will you accept corrected information directly from the customer? Please explain.

25. Do you require a more detailed explanation from a female applicant vs. a male applicant? If yes, please explain.
26. Are there any circumstances in which you would not require an explanation for derogatory credit? If yes, please list the circumstances.
27. Do you accept explanations such as “unforeseen circumstances” or “factors beyond my control”? If yes, please explain your answer.
28. What deficiencies would cause rejections if not adequately explained?
29. Does a mortgage payment defect negate otherwise good credit?
30. Does a good mortgage payment record offset other credit defects?
31. Is derogatory information associated with a medical problem in the applicant’s household treated differently than other derogatory information?
32. How do you view judgments, repossessions, and collections?
33. Under what circumstances would you lend to an applicant with a bankruptcy in his or her record?
34. What constitutes a sufficient credit history on which to make a loan decision?
35. Have you made a loan to an applicant(s) who has not meet the standards above? If so, what evidence of creditworthiness substituted for the credit bureau report?
36. How do you view inquiries?
37. Would you ever deem credit deficient solely on the basis of inquiries?
38. Loan Officers are the only bank employees who have fair lending responsibilities? True or False.
39. Do you, on occasion, pull a credit bureau report without having a written loan application, just to let someone know their chances of approval? If yes, how often and under what circumstances?
40. Is the bank permitted to deny a 30 year mortgage loan to an 80 year old applicant, because they are “too old”? True or False.
41. Can the bank be held accountable for actions by third parties who provide us with loan applications (dealers, mortgage brokers, etc.)? True or False.
42. Under what circumstance are you permitted to ask about an applicant’s religion?
43. If you know that an applicant will not qualify for the loan, do you recommend that they not complete an application as it would be a “waste of time”? If yes, please explain.
44. Under what circumstances are you required to collect government monitoring information (race, ethnicity, and sex)?

45. If an applicant does not qualify for a loan on their own, would you recommend that their spouse sign on the loan to "make the approval process quicker"? Please explain your answer.
46. Would you require an hispanic applicant to provide a more detailed explanation for a derogatory credit history than a white applicant who was referred to you by the bank president? If yes, please explain.
47. Would you refuse to take an automobile application for an applicant who is in a wheelchair? If yes, please explain.
48. Under what circumstance are you permitted to ask about an applicant's marital status?
49. In an application to purchase a primary residence, would you apply a higher debt to income ratio standard for applicant(s) with two (2) children compared to applicant(s) with seven (7) children?
50. Would you ever consider compensating factors when deciding whether to approve or deny an application? If so, what factors?

Steps to Follow

The following steps should be followed when completing the lender questionnaire test.

- ***Choose the questions to be answered.*** The list of questions will need to be tailored to the types of loans that you are auditing, the bank's policies and procedures, etc. Not all banks will need all of the questions.
- ***Have the lending staff respond to the questions.*** You need to choose to do this as a questionnaire or a test. If it is a test, then you need to proctor the test. If it is only a questionnaire, then the lenders can complete it in their office and return it. If they open the bank's policy to determine an answer, at least you know that they have now read that section of the policy.
- ***Review and analyze the answers.*** This is the most important portion of this process. When this is complete, you should be able to share with management all issues noted. You also should have potential solutions ready, if management is amenable to receiving solutions from the compliance officer.
- ***Complete your review.*** The answers provided will "aim" your audit at the areas which may be the most vulnerable in the area of fair lending.

Solutions

After your audit and carefully analyzing the answers to each question, the bank must decide what action, if any, is necessary.

- Update Loan Policy

- Provide additional training to the lending staff
- Clarify an answer provided by the lending staff

Management must implement policies and procedures to correct any issues found, provide training, or take other steps to address the issues found.

You need to completely document the steps that were taken, as it may become important later on. Management may want to acknowledge that you had already found and addressed the deficiency.

Sample: Lender Questionnaire

Objectives

Review the following questionnaires completed by three different lenders at the same bank. Each of the lenders have significant time in the bank as lenders. They were required to complete this survey without using any bank policies or procedures for reference.

You will note that they have different points of view regarding the bank's lending policy, which may have created some fair lending issues for the bank.

In preparation for the impending mortgage loan audit, your goal is to attempt to identify the "target" groups, which should be considered as focal points in the review. You also need to determine other issues that you might wish to pursue in a file review fair lending audit

In addition to determining the "target" groups, also determine whether other types of remedial steps management may wish to consider.

Lender Questionnaire Results

Consumer Unsecured	Lender #1	Lender #2	Lender #3
Front End Ratio (Housing to Income Ratio)	N/A	N/A	N/A
Back End Ratio (Total Debt to Income Ratio)	45%	40%	40% (if credit score 700 or above) 25% (if credit score under 700)
Loan to Value Ratio (without PMI)	N/A	N/A	N/A
Length of Employment	5 years	2 years	N/A
Minimum Credit Score	675	640	575
Minimum Loan Amount	$1,000	$1,000	None
Maximum Loan Amount	N/A	N/A	N/A

Consumer Secured	Lender #1	Lender #2	Lender #3
Front End Ratio (Housing to Income Ratio)	N/A	N/A	N/A
Back End Ratio (Total Debt to Income Ratio)	40%	40%	40% (if credit score 700 or above) 25% (if credit score under 700)
Loan to Value Ratio (without PMI)	Varies based on collateral	Varies on collateral	Varies on collateral
Length of Employment	5 years	2 years	N/A
Minimum Credit Score	675	640	575
Minimum Loan Amount	$5,000	$1,000	None
Maximum Loan Amount	N/A	N/A	N/A

Consumer Mortgage Loan	**Lender #1**	**Lender #2**	**Lender #3**
Front End Ratio (Housing to Income Ratio)	28%	28%	28%
Back End Ratio (Total Debt to Income Ratio)	50%	40%	45% (in-house loans) Up to 50% (secondary market loans)
Loan to Value Ratio (without PMI)	90%	90%	80%
Length of Employment	2 years	2 years	2 years
Minimum Credit Score	700	640	600
Minimum Loan Amount	$50,000	$10,000	$10,000
Maximum Loan Amount	$450,000	$400,000	N/A

	Lender #1	**Lender #2**	**Lender #3**
If a loan does not meet the criteria mentioned above, are there mitigating factors that are commonly used to determine potential approvals?	Yes	Yes	Yes.
If the answer to question 2 was yes, please list them (i.e. high net worth, etc.):	Current or previous loan customer Qualified co-signer Large deposits	High net worth Reasonable cash reserves Positive credit history with the bank	Personal acquaintance (fellow church parishioner, friend, family, fellow country club members)
How frequently are the considerations listed in question 3 used in a loan decision?	Not very often. Maybe less than 5% of the time.	Only as necessary. Usually for younger applicants, since they are in the beginning of their credit life-cycle.	Fairly often, since this is a small town and most of my loan requests come from people I know. Bank employees know I like to deal with repeat customers.
When these considerations are used to approve a loan, is the explanation documented in the file?	It is discussed with the applicants and explained to the loan committee, if necessary.	Most definitely.	Not really necessary.
How do you determine the following:	Interest rates – current economic conditions, deposit balances, location of collateral Loan term – bank policy Loan fees – whatever the market will bear Other conditions of lending – case by case decision	Interest rates – as stated by loan committee Loan term – bank policy Loan fees – as stated by loan committee Other conditions of lending – none	Interest rates – based on deposit levels and credit score Loan term – based on collateral Loan fees – as noted by bank president Other conditions of lending – none
How much flexibility do you have in determining these factors?	The better rate that I negotiate the more money the bank makes.	None that I am aware.	Whatever the market will bear.

Can any rates or fees be negotiated?	Yes.	No.	Yes.
Under what circumstances would a co-maker or guarantor be necessary?	If I or the loan committee feels there is greater risk.	If my boss tells me to.	If the applicant is not qualified (i.e., meets the conditions in #1 above)
How do you determine who the guarantor or co-maker should be?	Depends if the applicant has any local family members available. Friends and acquaintances usually are not considered.	I don't. I simply ask for a qualified one.	Several ways, but mostly by marital status.
Do you verify income for all customers? If no, what criteria do you use to determine whether you will verify income?	No. Only on new loan customers unless the applicant had been a loan customer within the past 12 months.	Always.	No. Only those I do not know.
If applicable, how do you complete the verification?	Obtain a copy of a recent pay stub and annualize the amount for most loans. I will request tax returns for self-employed applicants.	One month's history of pay stubs for non real estate loans. Verification of employment for real estate loans. Use tax returns for self-employed applicants.	Verifications of employment.
When calculating the customer's debt to income ratios, do you exclude any types of income? If yes, please list the types of income and comment as to why they are excluded.	No.	Yes. Part-time income if less than 15 hours per week. Tax exempt income is used, but only portion as "take home".	Yes, child support.
Are there any credit obligations that would not be included in the debt to income ratio calculations? If yes, please explain.	Anything with a balance of $500 or less.	Credit cards for students are not considered if that is all they have.	No. All debt is considered.
If a customer has collections or other credit deficiencies, what percentage of the time do you request an explanation of the collections or deficiencies?	Hard to tell. I ask for explanations if I do not personally know the applicant or if they are not medical in nature.	100 percent.	Again, only for those new customers that I do not personally know.

If you request an explanation, do you require it to be in writing? If the answer is yes, what percentage of the time do you assist in the preparation of the explanation?	No.	Yes. I try and help when necessary.	Yes. I let them explain it.
Do you accept explanations such as "unforeseen circumstances" or "factors beyond my control"? If yes, please explain your answer.	No. These are just excuses. Everyone should be financial responsible.	Yes, unless they have a really low credit score.	No.

You will note that any "special" fair lending review has multiple "targets."

Application, Approval, Account Opening, and Denial Audit

Section 1: Rules Concerning Requests for Information 12 CFR §1002.5

General Rules – 12 CFR §1002.5(a)

Regulatory Discussion

The general rule regarding requests for information states a creditor may obtain any information in connection with a credit transaction; however, this section governs the types of information a creditor may gather. Section 6 (§1002.6) of this manual governs how the information may be used.

Specifically for credit secured by the applicant's dwelling, a creditor shall request government monitoring information (GMI) (see Section 13 of this manual, §1002.13).

- Note the commentary for "Information required by Regulation C" (HMDA) and "Collecting information on behalf of creditors".
- Specifically to monitor or enforce compliance with the ECOA, Regulation B, or other Federal or state statutes or regulations, a creditor may obtain information required by a court or enforcement agency.
- Note the commentary for "Local laws" and "Collecting information on behalf of creditors."

Specifically for special-purpose credit, a creditor may obtain information to determine eligibility (see Section 8 of this manual, §§1002.8(b), (c), and (d)).

Exceptions: Paragraphs (b), (c) and (d), discussed in greater detail within this Section 5, include limitations on the following types of information:

- Generally, a creditor shall not inquire about the race, color, religion, national origin, or sex of an applicant or any other person in connection with a credit transaction (exceptions apply).
- Generally, a creditor may not request any information concerning the spouse or former spouse of an applicant (exceptions apply).

Generally, a creditor shall not inquire:

- about the applicant's marital status (exceptions apply);
- whether income stated is derived from alimony, child support, or separate maintenance payments (exceptions apply);
- about birth control practices, intentions concerning bearing/rearing of children, or capability to bear children (exceptions apply).

Finally, the CFPB added an amendment to Regulation B which will add paragraph (4) under §1002.5(a) titled "Other permissible collection of information." In essence, this is somewhat of a technical amendment that will permit a creditor to collect information that is specifically required by Regulation C (HMDA). Minor conforming changes are also proposed for comment

5(a)(2)-2 to reference the types of loans covered by revised Regulation C and provide a citation to Regulation C. And, a new comment, 5(a)(4)-1, is proposed to be added to provide guidance on the new proposed paragraph (4).

Regulatory Text

(a) **General rules**

(1) **Requests for information.** Except as provided in paragraphs (b) through (d) of this section, a creditor may request any information in connection with a credit transaction. This paragraph does not limit or abrogate any Federal or state law regarding privacy, privileged information, credit reporting limitations, or similar restrictions on obtainable information.

(2) **Required collection of information.** Notwithstanding paragraphs (b) through (d) of this section, a creditor shall request information for monitoring purposes as required by §1002.13 for credit secured by the applicant's dwelling. In addition, a creditor may obtain information required by a regulation, order, or agreement issued by, or entered into with, a court or an enforcement agency (including the Attorney General of the United States or a similar state official) to monitor or enforce compliance with the Act, this part, or other Federal or state statutes or regulations.

(3) **Special - purpose credit.** A creditor may obtain information that is otherwise restricted to determine eligibility for a special purpose credit program, as provided in §§1002.8(b), (c), and (d).

(4) **Other permissible collection of information.** Notwithstanding paragraph (b) of this section, a creditor may collect information under the following circumstances provided that the creditor collects the information in compliance with appendix B to 12 CFR part 1003:

(i) A creditor that is a financial institution under 12 CFR 1003.2(g) may collect information regarding the ethnicity, race, and sex of an applicant for a closed-end mortgage loan that is an excluded transaction under 12 CFR 1003.3(c)(11) if it submits HMDA data concerning such closed-end mortgage loans and applications or if it submitted HMDA data concerning closed-end mortgage loans for any of the preceding five calendar years;

(ii) A creditor that is a financial institution under 12 CFR 1003.2(g) may collect information regarding the ethnicity, race, and sex of an applicant for an open-end line of credit that is an excluded transaction under 12 CFR 1003.3(c)(12) if it submits HMDA data concerning such open-end lines of credit and applications or if it submitted HMDA data concerning open-end lines of credit for any of the preceding five calendar years;

(iii) A creditor that submitted HMDA data for any of the preceding five calendar years but is not currently a financial institution under 12 CFR 1003.2(g) may collect information regarding the ethnicity, race, and sex of an applicant for a loan that would otherwise be a covered loan under 12 CFR 1003.2(e) if not excluded by 12 CFR 1003.3(c)(11) or (12);

(iv) A creditor that exceeded an applicable loan volume threshold in the first year of the two-year threshold period provided in 12 CFR 1003.2(g), 1003.3(c)(11), or 1003.3(c)(12) may, in the second year, collect information regarding the ethnicity, race, and sex of an applicant for a loan that would otherwise be a covered loan under 12 CFR 1003.2(e) if the loan were not excluded by 12 CFR 1003.3(c)(11) or (12);

(v) A creditor that is a financial institution under 12 CFR 1003.2(g), or that submitted HMDA data for any of the preceding five calendar years but is not currently a financial institution under 12 CFR 1003.2(g), may collect information regarding the ethnicity, race, and sex of an applicant for a loan that would otherwise be a covered loan under 12 CFR 1003.2(e) if the loan were not excluded by 12 CFR 1003.3(c)(10).

(vi) A creditor that is collecting information regarding the ethnicity, race, and sex of an applicant or first co-applicant may collect information regarding the ethnicity, race, and sex of a second or additional co-applicant for a covered loan under 12 CFR 1003.2(e) or for a second or additional co-applicant for a loan described in paragraphs (a)(4)(i) through (v) of this section.

Regulatory Commentary

5(a) General rules.

Paragraph 5(a)(1).

*1. **Requests for information.** This section governs the types of information that a creditor may gather. Section1002.6 governs how information may be used.*

Paragraph 5(a)(2).

*1. **Local laws.** Information that a creditor is allowed to collect pursuant to a "state" statute or regulation includes information required by a local statute, regulation, or ordinance.*

*2. **Information required by Regulation C.** Regulation C, 12 CFR part 1003, generally requires creditors covered by the Home Mortgage Disclosure Act (HMDA) to collect and report information about the race, ethnicity, and sex of applicants for certain dwelling-secured loans, including some types of loans not covered by §1002.13.*

*3. **Collecting information on behalf of creditors.** Persons such as loan brokers and correspondents do not violate the ECOA or Regulation B if they collect information that they are otherwise prohibited from collecting, where the purpose of collecting the information is to provide it to a creditor that is subject to the Home Mortgage Disclosure Act or another Federal or state statute or regulation requiring data collection.*

Paragraph 5(a)(4).

1. ***Other permissible collection of information.*** Information regarding ethnicity, race, and sex that is not required to be collected pursuant to Regulation C, 12 CFR part 1003, may nevertheless be collected under the circumstances set forth in §1002.5(a)(4) without violating §1002.5(b). The information must be retained pursuant to the requirements of §1002.12.

Limitations on Information – 12 CFR §1002.5(b)

Regulatory Discussion

Except as permitted in §1002.5(a)(1) through (3), a creditor is generally prohibited from collecting information with respect to race, color, religion, national origin, or sex of an applicant or any other person associated with a credit transaction. There are two exceptions:

- When the creditor is conducting a **self-test** to monitor its compliance with the ECOA.
- When the creditor requests a title (i.e., Ms., Miss, Mr., or Mrs.) on an application form that indicates **sex**; provided the designation of title is disclosed as optional.

Inquiries about the sex of an applicant are generally prohibited in order to discourage sex discrimination in the lending process. The following are some of the situations that may be encountered which constitute sex discrimination, a prohibited consideration under the Fair Housing Act as well as the ECOA:

- Discounting or disregarding the income of a working wife or single woman
- Refusing to grant a loan, or granting a loan on different terms and conditions, because of sex
- Requiring more or different information from a female applicant than a male applicant (for example, birth control arrangements or a family plan)
- Subjecting a female applicant to a different or more extensive credit check than that which is usually required for males
- Refusing to include alimony or child support as viable income where evidence is provided of a history of consistent prior payment and indicates that payments are likely to continue
- Basing any aspect of a lending decision on general presumptions about women (for example, that women of childbearing age are poor risks)
- Treating single working parents differently from married working parents
- Requiring a cosigner for women but not for men

Regulatory Text

(b) **Limitation on information about race, color, religion, national origin, or sex.** A creditor shall not inquire about the race, color, religion, national origin, or sex of an applicant or any other person in connection with a credit transaction, except as provided in paragraphs (b)(1) and (b)(2) of this section.

(1) **Self-test.** A creditor may inquire about the race, color, religion, national origin, or sex of an applicant or any other person in connection with a credit transaction for the purpose of conducting a self-test that meets the requirements of §1002.15. A creditor that makes such an inquiry shall disclose orally or in writing, at the time the information is requested, that:

(i) The applicant will not be required to provide the information;

(ii) The creditor is requesting the information to monitor its compliance with the Federal Equal Credit Opportunity Act;

(iii) Federal law prohibits the creditor from discriminating on the basis of this information, or on the basis of an applicant's decision not to furnish the information; and

(iv) If applicable, certain information will be collected based on visual observation or surname if not provided by the applicant or other person.

(2) **Sex**. An applicant may be requested to designate a title on an application form (such as Ms., Miss, Mr., or Mrs.) if the form discloses that the designation of a title is optional. An application form shall otherwise use only terms that are neutral as to sex.

Regulatory Commentary

None.

Limitations on Information (Spouse or Former Spouse) – 12 CFR §1002.5(c)

Regulatory Discussion

Except as permitted in §1002.5(a)(1) through (3), a creditor is generally prohibited from collecting information concerning the applicant's spouse or former spouse. There are two exceptions:

- There are five circumstances, listed under permissible inquiries, whereby the creditor may request information concerning the applicant's spouse or former spouse.
  - Note: under paragraph (2)(iv), "community property states" include: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Alaska is an opt-in community property state that gives both parties the option to make their property community property.
- As provided under other accounts of the applicant, a creditor may request information on other accounts on which the applicant is "contractually liable" including the name address in whose name the account is held; as well as the names in which the applicant has previously received credit.

Regulatory Text

(c) **Information about a spouse or former spouse**

(1) **General rule.** Except as permitted in this paragraph, a creditor may not request any information concerning the spouse or former spouse of an applicant.

(2) **Permissible inquiries.** A creditor may request any information concerning an applicant's spouse (or former spouse under paragraph (c)(2)(v) of this section) that may be requested about the applicant if:

(i) The spouse will be permitted to use the account;

(ii) The spouse will be contractually liable on the account;

(iii) The applicant is relying on the spouse's income as a basis for repayment of the credit requested;

(iv) The applicant resides in a community property state or is relying on property located in such a state as a basis for repayment of the credit requested; or

(v) The applicant is relying on alimony, child support, or separate maintenance payments from a spouse or former spouse as a basis for repayment of the credit requested.

(3) **Other accounts of the applicant.** A creditor may request that an applicant list any account on which the applicant is contractually liable and to provide the name and address of the person in whose name the account is held. A creditor may also ask an applicant to list the names in which the applicant has previously received credit.

Regulatory Commentary

None.

Other Limitations on Information Requests (Marital Status) – 12 CFR §1002.5(d)(1)

Regulatory Discussion

Except as permitted in §1002.5(a)(1) through (3), a creditor is generally prohibited from collecting information with respect to the applicant's marital status. There are two exceptions:

- If an applicant applies for i*ndividual unsecured credit*, a creditor may inquire about the applicant's marital status if the applicant resides in a community property state or is relying on property located in such a state as a basis for repayment of the credit requested.
- If an application is for *other than individual unsecured credit*, a creditor may inquire about the applicant's marital status, using only the terms *married*, *unmarried*, and *separated*.

The commentary provides guidance on the indirect disclosure of prohibited information.

Regulatory Text

(d) **Other limitations on information requests**

(1) **Marital status.** If an applicant applies for individual unsecured credit, a creditor shall not inquire about the applicant's marital status unless the applicant resides in a community property state or is relying on property located in such a state as a basis for repayment of the credit requested. If an application is for other than individual unsecured credit, a creditor may inquire about the applicant's marital status, but shall use only the terms *married, unmarried,* and *separated.* A creditor may explain that the category unmarried includes single, divorced, and widowed persons.

Regulatory Commentary

5(d) Other limitations on information requests.

Paragraph 5(d)(1).

*1. **Indirect disclosure of prohibited information.** The fact that certain credit-related information may indirectly disclose marital status does not bar a creditor from seeking such information. For example, the creditor may ask about:*

i. The applicant's obligation to pay alimony, child support, or separate maintenance income.

ii. The source of income to be used as the basis for repaying the credit requested, which could disclose that it is the income of a spouse.

iii. Whether any obligation disclosed by the applicant has a co-obligor, which could disclose that the co-obligor is a spouse or former spouse.

iv. The ownership of assets, which could disclose the interest of a spouse.

Other Limitations on Information Requests (Alimony, Child Support, Separate Maintenance) – 12 CFR §1002.5(d)(2)

Regulatory Discussion

Except as permitted in §1002.5(a)(1) through (3), a creditor is generally prohibited from collecting information with respect to income derived from alimony, child support, or separate maintenance payments, unless the creditor discloses that such income need not be provided if the applicant does not want that income considered in determining creditworthiness.

The commentary provides guidance on appropriate methods to inquire about sources of income.

Regulatory Text

(d) **Other limitations on information requests**

(2) **Disclosure about income from alimony, child support, or separate maintenance.** A creditor shall not inquire whether income stated in an application is derived from

alimony, child support, or separate maintenance payments unless the creditor discloses to the applicant that such income need not be revealed if the applicant does not want the creditor to consider it in determining the applicant's creditworthiness.

Regulatory Commentary

5(d) Other limitations on information requests.

Paragraph 5(d)(2).

1. ***Disclosure about income.*** *The sample application forms in appendix B to the regulation illustrate how a creditor may inform an applicant of the right not to disclose alimony, child support, or separate maintenance income.*

2. ***General inquiry about source of income.*** *Since a general inquiry about the source of income may lead an applicant to disclose alimony, child support, or separate maintenance income, a creditor making such an inquiry on an application form should preface the request with the disclosure required by this paragraph.*

3. ***Specific inquiry about sources of income.*** *A creditor need not give the disclosure if the inquiry about income is specific and worded in a way that is unlikely to lead the applicant to disclose the fact that income is derived from alimony, child support, or separate maintenance payments. For example, an application form that asks about specific types of income such as salary, wages, or investment income need not include the disclosure.*

Other Limitations on Information Requests (Childbearing, Childrearing) – 12 CFR §1002.5(d)(3)

Regulatory Discussion

Except as permitted in §1002.5(a)(1) through (3), a creditor is generally prohibited from collecting information with respect to childbearing and/or childrearing practices, intentions and capabilities. There is one exception:

- A creditor may inquire about the number and ages of an applicant’s dependents to determine dependent-related financial obligations or expenditures that may affect creditworthiness.

Regulatory Text

(d) **Other limitations on information requests**

(3) **Childbearing, childrearing.** A creditor shall not inquire about birth control practices, intentions concerning the bearing or rearing of children, or capability to bear children. A creditor may inquire about the number and ages of an applicant's dependents or about dependent-related financial obligations or expenditures, provided such information is requested without regard to sex, marital status, or any other prohibited basis.

Regulatory Commentary

None.

Permanent Residency and Immigration Status – 12 CFR §1002.5(e)

Regulatory Discussion

There is *no prohibition* against a creditor from inquiring about an applicant's, or any other person associated with a credit transaction, permanent residency or immigration status. This can be important information to consider, for example, in the event of default.

A creditor is not allowed to refuse to grant credit because an applicant comes from a particular country, but may take the applicant's immigration status into account. A creditor may also take into account any applicable law, regulation, or executive order that restricts dealings with citizens (or the government) of a particular country or that imposes limitations on extensions of credit to them.

Regulatory Text

(e) **Permanent residency and immigration status.** A creditor may inquire about the permanent residency and immigration status of an applicant or any other person in connection with a credit transaction.

Regulatory Commentary

None.

Technique

In order to complete this audit, you will have to open files and examine applications. Some of the data (good or bad) may come from the lender survey discussed above. You could add questions there which might limit your audit work here. The answers to each question may be yes, no, or N/A.

The following is a list of questions that need answered for every file application you audit.

Questions

Government Monitoring Information:

- HMDA Bank: Did the lender, for credit that will be HMDA reportable, request as part of the application the following information regarding the applicant(s):
  - Ethnicity and race using the disaggregated information
  - Sex
  - Marital status, using the categories married, unmarried, and separated
  - Age
- Non-HMDA Bank: Did the lender, for credit that will be for purchase or refinance of purchase money, principal residence loan, request as part of the application the following information regarding the applicant(s):
  - Ethnicity and race using the either the aggregated or disaggregated information
  - Sex
  - Marital status, using the categories married, unmarried, and separated
  - Age

Obtaining Information

- The applicant(s) is not required to supply the information. If the applicant(s) does not supply the information, does the form adequately state this?
- If the applicant(s) refused to provide this information, and the application was face to face, did the lender complete this portion of the application based on visual observation or surname?
- If the applicant(s) refused to provide this information, and the application was not face to face, did the lender make this clear on this portion of the application
- If the information was inadvertently obtained, did the lender state how this occurred?

Disclosure to Applicants

- Did the lender inform the applicant(s) that the information is requested by the Federal Government in order to monitor compliance with anti-discrimination statutes, and that they do not have to comply with the request, but if they choose not to provide the information, the creditor must note the information based on visual observation or surname
- When appropriately requesting the information, are your lenders presenting the requirement adequately to your customers? You probably will not find this in the file - this will have to be a conversation with your lenders.
- Are your lenders requesting titles such as Ms., Miss, Mr., or Mrs. appropriately?
- Are your lenders avoiding questions about race, color, religion, national origin, or sex of an applicant or any other person appropriately?

Spousal Limitations:

- Are your lenders limiting questions about spouses or former spouses to these situations?
    - The spouse will be permitted to use the account;
    - The spouse will be contractually liable on the account;
    - The applicant is relying on the spouse's income as a basis for repayment of the credit requested;

  - The applicant resides in a community property state or is relying on property located in such a state as a basis for repayment of the credit requested; or

  - The applicant is relying on alimony, child support, or separate maintenance payments from a spouse or former spouse as a basis for repayment of the credit requested.

Other Accounts of the Applicant:

- Are your lenders limiting request for other accounts to accounts on which the applicant is contractually liable and to provide the name and address of the person in whose name the account is held?

Marital Status:

- Are your lenders limiting the questions for marital status to loans other than individual unsecured credit?

Alimony, Child Support, Separate Maintenance:

- Are your lenders telling applicants that they do not have to include alimony, child support, or separate maintenance payments unless the applicant wants you to consider it in determining the applicant's creditworthiness?

Childbearing, Childrearing"

- Are your lenders limiting the discussion of childbearing and childrearing to the number and ages of an applicant's dependents to determine dependent-related financial obligations or expenditures that may affect creditworthiness?

Permanent Residency and Immigration Status:

- Are your lenders appropriately inquiring into the permanent residency and immigration status of an applicant or any other person in connection with a credit transaction?

Section 3: Rules Concerning Evaluation of Applications

12 CFR § 1002.6

General Rule Concerning Use of Information – 12 CFR §1002.6(a)

Regulatory Discussion

This section governs how the information collected in an application may be used to evaluate creditworthiness. In general, a creditor may consider any information obtained in an application, so long as the information is not used to discriminate on a prohibited basis.

When Congress passed the ECOA, it intended to apply an "effects test" concept to a creditor's determination of creditworthiness. In essence, *a creditor practice that is discriminatory in effect is prohibited* because it has a disproportionately negative impact on a prohibited basis. For example, requiring that applicants have income in excess of a certain amount to qualify for an overdraft line of credit could mean that women and minority applicants will be rejected at a higher rate than men and nonminority applicants.

Regulatory Text

(a) **General rule concerning use of information.** Except as otherwise provided in the Act and this part, a creditor may consider any information obtained, so long as the information is not used to discriminate against an applicant on a prohibited basis. The legislative history of the Act indicates that the Congress intended an "effects test" concept, as outlined in the employment field by the Supreme Court in the cases of *Griggs* v. *Duke Power Co.,* 401 U.S. 424 (1971), and *Albemarle Paper Co.* v. *Moody,* 422 U.S. 405 (1975), to be applicable to a creditor's determination of creditworthiness.

Regulatory Commentary

6(a) General rule concerning use of information.

1. ***General.*** *When evaluating an application for credit, a creditor generally may consider any information obtained. However, a creditor may not consider in its evaluation of creditworthiness any information that it is barred by §1002.5 from obtaining or from using for any purpose other than to conduct a self-test under §1002.15.*

2. ***Effects test.*** *The effects test is a judicial doctrine that was developed in a series of employment cases decided by the U.S. Supreme Court under title VII of the Civil Rights Act of 1964 (42 U.S.C. 2000e et seq.,) and the burdens of proof for such employment cases were codified by Congress in the Civil Rights Act of 1991 (42 U.S.C. 2000e-2). Congressional intent that this doctrine apply to the credit area is documented in the Senate Report that accompanied H.R. 6516, No. 94-589, pp. 4-5; and in the House Report that accompanied H.R. 6516, No. 94-210, p.5. The Act and regulation may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the* *creditor has no intent to discriminate and the practice appears neutral on its face, unless the creditor practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact. For example, requiring that applicants have income in excess of a certain amount to qualify for an overdraft line of credit could mean that women and minority applicants will be rejected at a higher rate than men and nonminority applicants. If there is a demonstrable relationship between the income requirement and creditworthiness for the level of credit involved, however, use of the income standard would likely be permissible.*

Specific Rules Concerning Use of Information – 12 CFR §1002.6(b)(1)

Regulatory Discussion

In general, except for *special purpose credit programs* (see Section 8 of this manual), a creditor shall not discriminate, on a prohibited basis, in the evaluation of an applicant's creditworthiness.

Paragraphs (b)(2) through (b)(9) provide specific rules on the following information:

- Age and receipt of public assistance
- Childbearing and childrearing
- Telephone listing
- Income
- Credit history
- Immigration status
- Marital status
- Race, color, national origin, sex (GMI), and religion

Regulatory Text

(b) **Specific rules concerning use of information.**

(1) Except as provided in the Act and this part, a creditor shall not take a prohibited basis into account in any system of evaluating the creditworthiness of applicants.

Regulatory Commentary

Paragraph 6(b)(1).

*1. **Prohibited basis - special purpose credit.** In a special purpose credit program, a creditor may consider a prohibited basis to determine whether the applicant possesses a characteristic needed for eligibility. (See §1002.8.)*

Specific Rules (Age and Receipt of Public Assistance) – 12 CFR §1002.6(b)(2)

Regulatory Discussion

Generally, a creditor shall not take into consideration an applicant's age (subject to capacity to contract) or whether income is derived from any public assistance program. There are three exceptions; a creditor may consider:

- An applicant's age as a predictive variable in an empirically derived credit scoring system provided the age of an elderly (age 62 or older) applicant is not assigned a negative factor or value.
- An applicant's age or whether income is derived from any public assistance program, in a judgmental system of evaluating creditworthiness – only for the purpose of determining a pertinent element of creditworthiness.
- The age of an elderly (age 62 or older) applicant – when such age is used to favor the applicant.

As a special note, banks should beware of developing "seniors account" packages that offer advantageous credit incentives when the minimum age to have the package is less than 62.

As the examples in commentary illustrate, the evaluation must be made in an individualized, case-by-case manner. It is impermissible for a creditor, in deciding whether to extend credit or in setting the terms and conditions, to base its decision on age or information related exclusively to age. Age or age-related information may be considered only in evaluating other "pertinent elements of creditworthiness" that are drawn from the particular facts and circumstances concerning the applicant.

Regulatory Text

(b) **Specific rules concerning use of information.**

(2) **Age, receipt of public assistance.**

(i) Except as permitted in this paragraph, a creditor shall not take into account an applicant's age (provided that the applicant has the capacity to enter into a binding contract) or whether an applicant's income derives from any public assistance program.

(ii) In an empirically derived, demonstrably and statistically sound, credit scoring system, a creditor may use an applicant's age as a predictive variable, provided that the age of an elderly applicant is not assigned a negative factor or value.

(iii) In a judgmental system of evaluating creditworthiness, a creditor may consider an applicant's age or whether an applicant's income derives from any public assistance program only for the purpose of determining a pertinent element of creditworthiness.

(iv) In any system of evaluating creditworthiness, a creditor may consider the age of an elderly applicant when such age is used to favor the elderly applicant in extending credit.

Regulatory Commentary

Paragraph 6(b)(2).

1. ***Favoring the elderly.*** *Any system of evaluating creditworthiness may favor a credit applicant who is age 62 or older. A credit program that offers more favorable credit terms to applicants age 62 or older is also permissible; a program that offers more favorable credit terms to applicants at an age lower than 62 is permissible only if it meets the special-purpose credit requirements of §1002.8.*

2. ***Consideration of age in a credit scoring system.*** *Age may be taken directly into account in a credit scoring system that is "demonstrably and statistically sound," as defined in §1002.2(p), with one limitation: Applicants age 62 years or older must be treated at least as favorably as applicants who are under age 62. If age is scored by assigning points to an applicant's age category, elderly applicants must receive the same or a greater number of points as the most favored class of nonelderly applicants.*

i. ***Age-split scorecards.*** *Some credit systems segment the population and use different scorecards based on the age of an applicant. In such a system, one card may cover a narrow age range (for example, applicants in their twenties or younger) who are evaluated under attributes predictive for that age group. A second card may cover all other applicants, who are evaluated under the attributes predictive for that broader class. When a system uses a card covering a wide age range that encompasses elderly applicants, the credit scoring system is not deemed to score age. Thus, the system does not raise the issue of assigning a negative factor or value to the age of elderly applicants. But if a system segments the population by age into multiple scorecards, and includes elderly applicants in a narrower age range, the credit scoring system does score age. To comply with the Act and regulation in such a case, the creditor must ensure that the system does not assign a negative factor or value to the age of elderly applicants as a class.*

3. ***Consideration of age in a judgmental system.*** *In a judgmental system, defined in §1002.2(t), a creditor may not decide whether to extend credit or set the terms and conditions of credit based on age or information related exclusively to age. Age or age-related information may be considered only in evaluating other "pertinent elements of creditworthiness" that are drawn from the particular facts and circumstances concerning the applicant. For example, a creditor may not reject an application or terminate an account because the applicant is 60 years old. But a creditor that uses a judgmental system may relate the applicant's age to other information about the applicant that the creditor considers in evaluating creditworthiness. As the following examples illustrate, the evaluation must be made in an individualized, case-by-case manner:*

i. A creditor may consider the applicant's occupation and length of time to retirement to ascertain whether the applicant's income (including retirement income) will support the extension of credit to its maturity.

ii. A creditor may consider the adequacy of any security offered when the term of the credit extension exceeds the life expectancy of the applicant and the cost of realizing on the collateral could exceed the applicant's equity. An elderly applicant might not qualify for a 5 percent down, 30-year mortgage loan but might qualify with a larger downpayment or a shorter loan maturity.

iii. A creditor may consider the applicant's age to assess the significance of length of employment (a young applicant may have just entered the job market) or length of time at an address (an elderly applicant may recently have retired and moved from a long-term residence).

4. ***Consideration of age in a reverse mortgage.*** *A reverse mortgage is a home-secured loan in which the borrower receives payments from the creditor, and does not become obligated to repay these amounts (other than in the case of default) until the borrower dies, moves permanently from the home, or transfers title to the home, or upon a specified maturity date. Disbursements to the borrower under a reverse mortgage typically are determined by considering the value of the borrower's home, the current interest rate, and the borrower's life expectancy. A reverse mortgage program that requires borrowers to be age 62 or older is permissible under §1002.6(b)(2)(iv). In addition, under §1002.6(b)(2)(iii), a creditor may consider a borrower's age to evaluate a pertinent element of creditworthiness, such as the amount of the credit or monthly payments that the borrower will receive, or the estimated repayment date.*

5. ***Consideration of age in a combined system.*** *A creditor using a credit scoring system that qualifies as "empirically derived" under §1002.2(p) may consider other factors (such as a credit report or the applicant's cash flow) on a judgmental basis. Doing so will not negate the classification of the credit scoring component of the combined system as "demonstrably and statistically sound." While age could be used in the credit scoring portion, however, in the judgmental portion age may not be considered directly. It may be used only for the purpose of determining a "pertinent element of creditworthiness." (See comment 6(b)(2)-3.)*

6. ***Consideration of public assistance.*** *When considering income derived from a public assistance program, a creditor may take into account, for example:*

   i. The length of time an applicant will likely remain eligible to receive such income.

   ii. Whether the applicant will continue to qualify for benefits based on the status of the applicant's dependents (as in the case of Temporary Aid to Needy Families, or social security payments to a minor).

   iii. Whether the creditor can attach or garnish the income to assure payment of the debt in the event of default.

Specific Rules (Childbearing and Childrearing) – 12 CFR §1002.6(b)(3)

Regulatory Discussion

A creditor is prohibited, *without exception*, from making assumptions, or using statistics, regarding childbearing or childrearing practices, intentions or capabilities, in evaluating creditworthiness.

Regulatory Text

(b) **Specific rules concerning use of information.**

(3) **Childbearing, childrearing.** In evaluating creditworthiness, a creditor shall not make assumptions or use aggregate statistics relating to the likelihood that any category of persons will bear or rear children or will, for that reason, receive diminished or interrupted income in the future.

Regulatory Commentary

None.

Specific Rules (Telephone Listing) – 12 CFR §1002.6(b)(4)

Regulatory Discussion

A creditor is prohibited from taking into account whether there is a telephone listing in the applicant's name for consumer credit; however, a creditor may consider whether there is a telephone in the applicant's residence.

Regulatory Text

(b) **Specific rules concerning use of information.**

(4) **Telephone listing.** A creditor shall not take into account whether there is a telephone listing in the name of an applicant for consumer credit but may take into account whether there is a telephone in the applicant's residence.

Regulatory Commentary

None.

Specific Rules (Income) – 12 CFR §1002.6(b)(5)

Regulatory Discussion

A creditor shall not discount, or exclude from consideration, income because of a prohibited basis or because the income is derived from part-time employment, an annuity, pension, or other retirement benefit. However, a creditor may consider the amount and probable continuance of any income in evaluating creditworthiness.

A creditor shall consider alimony, child support, or separate maintenance payments as income (to the extent such payments are likely to be consistently made) when an applicant relies on such payments when applying for credit.

Creditors are also obligated to consider whether a source of income is taxable under Federal law. For example, if a customer is in a 20 percent bracket for income tax purposes, $1,000 in non-taxable income equates to $1,200 in taxable income. Each institution must determine a factor for conversion of non-taxable income into taxable income equivalent. This process is known as "grossing up" the income. As income must be treated consistently by each institution, grossing up must occur before the calculation of any debt-to-income ratios.

The commentary provides additional guidance with respect to consideration of income.

Regulatory Text

(b) **Specific rules concerning use of information.**

(5) **Income.** A creditor shall not discount or exclude from consideration the income of an applicant or the spouse of an applicant because of a prohibited basis or because the income is derived from part-time employment or is an annuity, pension, or other retirement benefit; a creditor may consider the amount and probable continuance of any income in evaluating an applicant's creditworthiness. When an applicant relies on alimony, child support, or separate maintenance payments in applying for credit, the creditor shall consider such payments as income to the extent that they are likely to be consistently made.

Regulatory Commentary

Paragraph 6(b)(5).

1. ***Consideration of an individual applicant.*** *A creditor must evaluate income derived from part-time employment, alimony, child support, separate maintenance payments, retirement benefits, or public assistance on an individual basis, not on the basis of aggregate statistics; and must assess its reliability or unreliability by analyzing the applicant's actual circumstances, not by analyzing statistical measures derived from a group.*

2. ***Payments consistently made.*** *In determining the likelihood of consistent payments of alimony, child support, or separate maintenance, a creditor may consider factors such as whether payments are received pursuant to a written agreement or court decree; the length of time that the payments have been received; whether the payments are regularly received by the applicant; the availability of court or other procedures to compel payment; and the creditworthiness of the payor, including the credit history of the payor when it is available to the creditor.*

3. ***Consideration of income.***

i. A creditor need not consider income at all in evaluating creditworthiness. If a creditor does consider income, there are several acceptable methods, whether in a credit scoring or a judgmental system:

A. A creditor may score or take into account the total sum of all income stated by the applicant without taking steps to evaluate the income for reliability.

B. A creditor may evaluate each component of the applicant's income, and then score or take into account income determined to be reliable separately from other income; or the creditor may disregard that portion of income that is not reliable when it aggregates reliable income.

C. A creditor that does not evaluate all income components for reliability must treat as reliable any component of protected income that is not evaluated.

ii. In considering the separate components of an applicant's income, the creditor may not automatically discount or exclude from consideration any protected income. Any discounting or exclusion must be based on the applicant's actual circumstances.

*4. **Part-time employment, sources of income.** A creditor may score or take into account the fact that an applicant has more than one source of earned income—a full-time and a part-time job or two part-time jobs. A creditor may also score or treat earned income from a secondary source differently than earned income from a primary source. The creditor may not, however, score or otherwise take into account the number of sources for income such as retirement income, social security, supplemental security income, and alimony. Nor may the creditor treat negatively the fact that an applicant's only earned income is derived from, for example, a part-time job.*

Specific Rules (Credit History) – 12 CFR §1002.6(b)(6)

Regulatory Discussion

There are three factors a creditor must consider when using an applicant's credit history in evaluating creditworthiness:

- When available, *the credit history of accounts the applicant is* (and spouse are) *permitted to use* (or for which both are contractually liable).
- When requested, *any information provided by the* applicant that indicates the credit history being considered by the creditor *does not accurately reflect the applicant's creditworthiness*.
- When requested, *the credit history* (when available) *of any account reported in the name of the applicant's spouse* (or former spouse) *that demonstrates accurately the applicant's creditworthiness*.

See the commentary for guidance on "*types of credit references*."

Regulatory Text

(b) **Specific rules concerning use of information.**

(6) **Credit history.** To the extent that a creditor considers credit history in evaluating the

creditworthiness of similarly qualified applicants for a similar type and amount of credit, in evaluating an applicant's creditworthiness a creditor shall consider:

(i) The credit history, when available, of accounts designated as accounts that the applicant and the applicant's spouse are permitted to use or for which both are contractually liable;

(ii) On the applicant's request, any information the applicant may present that tends to indicate the credit history being considered by the creditor does not accurately reflect the applicant's creditworthiness; and

(iii) On the applicant's request, the credit history, when available, of any account reported in the name of the applicant's spouse or former spouse that the applicant can demonstrate accurately reflects the applicant's creditworthiness.

Regulatory Commentary

Paragraph 6(b)(6).

*1. **Types of credit references.** A creditor may restrict the types of credit history and credit references that it will consider, provided that the restrictions are applied to all credit applicants without regard to sex, marital status, or any other prohibited basis. On the applicant's request, however, a creditor must consider credit information not reported through a credit bureau when the information relates to the same types of credit references and history that the creditor would consider if reported through a credit bureau.*

Specific Rules (Immigration Status) – 12 CFR §1002.6(b)(7)

Regulatory Discussion

A creditor may consider an applicant’s immigration, or permanent resident, status when evaluating creditworthiness as well as rights and remedies regarding repayment.

The commentary provides additional guidance on the differentiation between national origin, immigration status, and citizenship.

Regulatory Text

(b) **Specific rules concerning use of information.**

(7) **Immigration status.** A creditor may consider the applicant's immigration status or status as a permanent resident of the United States, and any additional information that may be necessary to ascertain the creditor's rights and remedies regarding repayment.

Regulatory Commentary

Paragraph 6(b)(7).

1. ***National origin - immigration status.*** *The applicant's immigration status and ties to the community (such as employment and continued residence in the area) could have a bearing on a creditor's ability to obtain repayment. Accordingly, the creditor may consider immigration status and differentiate, for example, between a noncitizen who is a long-time resident with permanent resident status and a noncitizen who is temporarily in this country on a student visa.*

2. ***National origin - citizenship.*** *A denial of credit on the ground that an applicant is not a United States citizen is not per se discrimination based on national origin.*

Specific Rules (Marital Status) – 12 CFR §1002.6(b)(8)

Regulatory Discussion

The rule for marital status requires a creditor to evaluate the creditworthiness of:

- *married and unmarried applicants* using the same standards; and
- *joint applicants* without regard of the existence, absence, or likelihood of a marital relationship between the parties.

The commentary, however, allows the creditor to consider marital status to ascertain rights and remedies.

Regulatory Text

(b) **Specific rules concerning use of information.**

(8) **Marital status.** Except as otherwise permitted or required by law, a creditor shall evaluate married and unmarried applicants by the same standards; and in evaluating joint applicants, a creditor shall not treat applicants differently based on the existence, absence, or likelihood of a marital relationship between the parties.

Regulatory Commentary

Paragraph 6(b)(8).

1. ***Prohibited basis - marital status.*** *A creditor may consider the marital status of an applicant or joint applicant for the purpose of ascertaining the creditor's rights and remedies applicable to the particular extension of credit. For example, in a secured transaction involving real property, a creditor could take into account whether state law gives the applicant's spouse an interest in the property being offered as collateral.*

Specific Rules (GMI and Religion) – 12 CFR §1002.6(b)(9)

Regulatory Discussion

The rule for race, color, national origin, sex (GMI), and religion prohibits a creditor to consider these factors *in any aspect of a credit transaction*.

Regulatory Text

(b) **Specific rules concerning use of information.**

(9) **Race, color, religion, national origin, sex.** Except as otherwise permitted or required by law, a creditor shall not consider race, color, religion, national origin, or sex (or an applicant's or other person's decision not to provide the information) in any aspect of a credit transaction.

Regulatory Commentary

None.

State Property Laws – 12 CFR §1002.6(c)

Regulatory Discussion

A creditor may consider, and apply, State property laws which does not constitute unlawful discrimination of the ECOA or Regulation B.

Regulatory Text

(c) **State property laws.** A creditor's consideration or application of state property laws directly or indirectly affecting creditworthiness does not constitute unlawful discrimination for the purposes of the Act or this part.

Regulatory Commentary

None.

Section 4: Audit of the Use of Information (Underwriting)

Technique

This technique (you will note) includes both fidelity to the rule and to your internal policies. This technique is focused on the approval process.

Questions

General

- Did the lender only consider information obtained, that did not discriminate against an applicant on a prohibited basis?

- Are there any “effects test” issues?

Age Discrimination

- Was there any evidence of age discrimination located in the file?

- If the bank uses a credit scoring system, is the age of an elderly applicant is not assigned a negative factor or value?

- If the bank uses a judgmental system of evaluating creditworthiness, did the underwriter consider an applicant's age only for the purpose of determining a pertinent element of creditworthiness?

Public Assistance Discrimination

- Was there evidence of discrimination based on all or part of the applicant's income coming from any public assistance program?

Childbearing and Childrearing

- Was there any evidence of discrimination regarding assumptions about the likelihood that the applicant will bear children or will, for that reason, receive diminished or interrupted income in the future?

Telephone Listing

- Was there any evidence of discrimination based on a telephone listing?

Income

- Was there any indication of discrimination based on the income being derived from part-time employment or is an annuity, pension, or other retirement benefit?

- Was there any indication of discrimination based on the fact that income was coming from alimony, child support, or separate maintenance payments?

- Were proper "gross ups" of income made based on bank policies?

Credit History

- Did the underwriter appropriately consider the applicant's credit history in evaluating their creditworthiness?

- Did the underwriter appropriately consider any other information that would reflect on the applicant's creditworthiness, either by information in the file or additional information provided by the applicant?

Immigration Status

- Did the underwriter appropriately consider the applicant's immigration, or permanent resident, status when evaluating creditworthiness as well as rights and remedies regarding repayment?

Marital Status

- Did the underwriter consider appropriately consider the applicant's marital status?

GMI and Religion

- Did the underwriter appropriately ignore race, color, national origin, sex (GMI), and religion in making the credit decision?

State Property Laws

- Did the underwriter appropriately consider state property laws in making the credit decision?

Section 5: Rules Concerning Extensions of Credit
12 CFR § 1002.7

Individual Accounts – 12 CFR §1002.7(a)

Regulation B has five specific rules (§1002.7(a) through (e)) regarding extensions of credit which will be discussed in this Section 7.

The first rule (§1002.7(a)) with respect to "individual accounts," prohibits a creditor from refusing to grant an individual account to a creditworthy applicant on the basis of sex, marital status, or any other prohibited basis.

See the commentary for guidance on the *designation, and choice, of an authorized user on open-end credit* as well as *authority to overdraft a transaction account*.

Regulatory Text

(a) **Individual accounts.** A creditor shall not refuse to grant an individual account to a creditworthy applicant on the basis of sex, marital status, or any other prohibited basis.

Regulatory Commentary

7(a) Individual accounts.

1. ***Open-end credit - authorized user.*** *A creditor may not require a creditworthy applicant seeking an individual credit account to provide additional signatures. But the creditor may condition the designation of an authorized user by the account holder on the authorized user's becoming contractually liable for the account, as long as the creditor does not differentiate on any prohibited basis in imposing this requirement.*
2. ***Open-end credit - choice of authorized user.*** *A creditor that permits an account holder to designate an authorized user may not restrict this designation on a prohibited basis. For example, if the creditor allows the designation of spouses as authorized users, the creditor may not refuse to accept a non-spouse as an authorized user.*
3. ***Overdraft authority on transaction accounts.*** *If a transaction account (such as a checking account or NOW account) includes an overdraft line of credit, the creditor may require that all persons authorized to draw on the transaction account assume liability for any overdraft.*

Designation of Name – 12 CFR §1002.7(b)

Regulatory Discussion

The second rule (§1002.7(b)) with respect to "designation of name," prohibits a creditor from refusing to allow an applicant to open or maintain an account in a birth-given first name and surname, including the spouse's surname, or a combined surname.

The commentary provides guidance on designating a single name, on joint applications, for purposes of account administration.

Regulatory Text

(b) **Designation of name.** A creditor shall not refuse to allow an applicant to open or maintain an account in a birth-given first name and a surname that is the applicant's birth-given surname, the spouse's surname, or a combined surname.

Regulatory Commentary

7(b) Designation of name.

1. ***Single name on account.*** *A creditor may require that joint applicants on an account designate a single name for purposes of administering the account and that a single name be embossed on any credit cards issued on the account. But the creditor may not require that the name be the husband's name. (See §1002.10 for rules governing the furnishing of credit history on accounts held by spouses.)*

Action Concerning Existing Open-End Accounts (Limitations) - 12 CFR §1002.7(c)(1)

Regulatory Discussion

Omitted.

Action Concerning Existing Open-End Accounts (Requiring Reapplication) - 12 CFR §1002.7(c)(2)

Regulatory Discussion

Omitted.

Signature of Spouse or Other Person (General) – 12 CFR § 1002.7(d)

Regulatory Discussion

The fourth rule (§1002.7(d)) with respect to "signatures of spouse or other person," is further segregated into six components: (1) "rule for qualified applicant;" (2) "unsecured credit;" (3) unsecured credit – community property states;" (4) "secured credit;" (5) "additional parties;" and

(6) "rights of additional parties."

The introductory commentary, applicable to all six components, provides additional guidance on *qualified applicant* and *unqualified applicant*.

Regulatory Text

None.

Regulatory Commentary

7(d) Signature of spouse or other person.

*1. **Qualified applicant.** The signature rules ensure that qualified applicants are able to obtain credit in their own names. Thus, when an applicant requests individual credit, a creditor generally may not require the signature of another person unless the creditor has first determined that the applicant alone does not qualify for the credit requested.*

*2. **Unqualified applicant.** When an applicant requests individual credit but does not meet a creditor's standards, the creditor may require a cosigner, guarantor, endorser, or similar party - but cannot require that it be the spouse. (See commentary to §§1002.7(d)(5) and (6).)*

Signature of Spouse or Other Person (Qualified Applicant) – 12 CFR § 1002.7(d)(1)

Regulatory Discussion

The first component of the fourth rule, paragraph (d)(1), "rule for qualified applicant," generally prohibits a creditor from requiring the signature of an applicant's spouse (or other person) on any credit instrument if the applicant qualifies for the amount and terms of credit requested.

- **Exception:** a creditor may require the signature of a *joint applicant* on any credit instrument.
- **Note:** the submission of a joint financial statement (or other evidence of jointly held assets) <u>does not</u> constitute an application for joint credit.

This signature rule assures that qualified applicants are able to obtain credit in their own names. Thus, when an applicant requests individual credit, a creditor generally may not require the signature of another person unless it has first been determined that the applicant alone does not qualify for the credit requested.

When an applicant applies for individual credit but does not alone meet a creditor's standards, a cosigner, guarantor, or the like may be required, but a creditor cannot require that it be the spouse or any other specific person.

The commentary provides additional information on three important topics: prohibition to require a cosigner; meaning of "joint applicant," and evidence of joint application.

Regulatory Text

(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.

Regulatory Commentary

Paragraph 7(d)(1).

1. ***Signature of another person.*** *It is impermissible for a creditor to require an applicant who is individually creditworthy to provide a cosigner—even if the creditor applies the requirement without regard to sex, marital status, or any other prohibited basis. (But see comment 7(d)(6)-1 concerning guarantors of closely held corporations.)*

2. ***Joint applicant.*** *The term "joint applicant" refers to someone who applies contemporaneously with the applicant for shared or joint credit. It does not refer to someone whose signature is required by the creditor as a condition for granting the credit requested.*

3. ***Evidence of joint application.*** *A person's intent to be a joint applicant must be evidenced at the time of application. Signatures on a promissory note may not be used to show intent to apply for joint credit. On the other hand, signatures or initials on a credit application affirming applicants' intent to apply for joint credit may be used to establish intent to apply for joint credit. (See appendix B.) The method used to establish intent must be distinct from the means used by individuals to affirm the accuracy of information. For example, signatures on a joint financial statement affirming the veracity of information are not sufficient to establish intent to apply for joint credit.*

Signature of Spouse or Other Person (Unsecured Credit) – 12 CFR § 1002.7(d)(2)

Regulatory Discussion

Omitted.

Signature of Spouse or Other Person (Unsecured Credit –

Community Property States) – 12 CFR § 1002.7(d)(3)

Regulatory Discussion

Omitted.

Signature of Spouse or Other Person (Secured Credit) – 12 CFR § 1002.7(d)(4)

Regulatory Discussion

The fourth component of the fourth rule, paragraph (d)(4), "secured credit," generally permits a creditor to require the signature of the applicant's spouse (or other person) on any instrument necessary to make property being offered as security available to satisfy the debt in the event of default. *This is applicable to an applicant requesting secured credit.*

The commentary provides guidance on three important topics: *creation of enforceable lien; need for signature;* and *integrated instruments*.

Regulatory Text

(d) **Signature of spouse or other person**

(4) **Secured credit.** If an applicant requests secured credit, a creditor may require the signature of the applicant's spouse or other person on any instrument necessary, or reasonably believed by the creditor to be necessary, under applicable state law to make the property being offered as security available to satisfy the debt in the event of default, for example, an instrument to create a valid lien, pass clear title, waive inchoate rights, or assign earnings.

Regulatory Commentary

Paragraph 7(d)(4).

*1. **Creation of enforceable lien.** Some state laws require that both spouses join in executing any instrument by which real property is encumbered. If an applicant offers such property as security for credit, a creditor may require the applicant's spouse to sign the instruments necessary to create a valid security interest in the property. The creditor may not require the spouse to sign the note evidencing the credit obligation if signing only the mortgage or other security agreement is sufficient to make the property available to satisfy the debt in the event of default. However, if under state law both spouses must sign the note to create an enforceable lien, the creditor may require the signatures.*

*2. **Need for signature - reasonable belief.** Generally, a signature to make the secured property available will only be needed on a security agreement. A creditor's reasonable belief that, to ensure access to the property, the spouse's signature is needed on an instrument that imposes* *personal liability should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general.*

3. ***Integrated instruments.*** *When a creditor uses an integrated instrument that combines the note and the security agreement, the spouse cannot be asked to sign the integrated instrument if the signature is only needed to grant a security interest. But the spouse could be asked to sign an integrated instrument that makes clear—for example, by a legend placed next to the spouse's signature—that the spouse's signature is only to grant a security interest and that signing the instrument does not impose personal liability.*

Signature of Spouse or Other Person (Additional Parties) – 12 CFR § 1002.7(d)(5)

Regulatory Discussion

The fifth component of the fourth rule, paragraph (d)(5), "additional parties," generally permits a creditor to request a cosignor, guarantor, endorser, or similar party if an additional party is necessary to support the credit request. *Note: the applicant's spouse (or other person) may serve as the additional party; however, the creditor may not require the spouse be the additional party*.

The commentary provides guidance on three important topics: *qualification of additional parties; reliance on income of another person*; and reevaluation of additional party in *renewals*.

Regulatory Text

(d) **Signature of spouse or other person**

(5) **Additional parties.** If, under a creditor's standards of creditworthiness, the personal liability of an additional party is necessary to support the credit requested, a creditor may request a cosigner, guarantor, endorser, or similar party. The applicant's spouse may serve as an additional party, but the creditor shall not require that the spouse be the additional party.

Regulatory Commentary

Paragraph 7(d)(5).

1. ***Qualifications of additional parties.*** *In establishing guidelines for eligibility of guarantors, cosigners, or similar additional parties, a creditor may restrict the applicant's choice of additional parties but may not discriminate on the basis of sex, marital status, or any other prohibited basis. For example, the creditor could require that the additional party live in the creditor's market area.*

2. ***Reliance on income of another person - individual credit.*** *An applicant who requests individual credit relying on the income of another person (including a spouse in a non-*

community property state) may be required to provide the signature of the other person to make the income available to pay the debt. In community property states, the signature of a spouse may be required if the applicant relies on the spouse's separate income. If the applicant relies on the spouse's future earnings that as a matter of state law cannot be characterized as community property until earned, the creditor may require the spouse's signature, but need not do so—even if it is the creditor's practice to require the signature when an applicant relies on the future earnings of a person other than a spouse. (See §1002.6(c) on consideration of state property laws.)

3. ***Renewals.*** *If the borrower's creditworthiness is reevaluated when a credit obligation is renewed, the creditor must determine whether an additional party is still warranted and, if not warranted, release the additional party.*

Signature of Spouse or Other Person (Rights of Additional Parties) – 12 CFR § 1002.7(d)(6)

Regulatory Discussion

The sixth component of the fourth rule, paragraph (d)(6), "rights of additional parties," simply prohibits the creditor from imposing any requirements upon an additional party that the creditor is prohibited from imposing upon an applicant.

The commentary provides important guidance on *guarantees* and *spousal guarantees*.

Regulatory Text

(d) **Signature of spouse or other person**

(6) **Rights of additional parties.** A creditor shall not impose requirements upon an additional party that the creditor is prohibited from imposing upon an applicant under this section.

Regulatory Commentary

Paragraph 7(d)(6).

1. ***Guarantees.*** *A guarantee on an extension of credit is part of a credit transaction and therefore subject to the regulation. A creditor may require the personal guarantee of the partners, directors, or officers of a business, and the shareholders of a closely held corporation, even if the business or corporation is creditworthy. The requirement must be based on the guarantor's relationship with the business or corporation, however, and not on a prohibited basis. For example, a creditor may not require guarantees only for women-owned or minority-owned businesses. Similarly, a creditor may not require guarantees only of the married officers of a business or the married shareholders of a closely held corporation.*

2. ***Spousal guarantees.*** *The rules in §1002.7(d) bar a creditor from requiring the signature of a guarantor's spouse just as they bar the creditor from requiring the signature of an applicant's*

spouse. For example, although a creditor may require all officers of a closely held corporation to personally guarantee a corporate loan, the creditor may not automatically require that spouses of married officers also sign the guarantee. If an evaluation of the financial circumstances of an officer indicates that an additional signature is necessary, however, the creditor may require the signature of another person in appropriate circumstances in accordance with §1002.7(d)(2).

Insurance – 12 CFR § 1002.7(e)

Regulatory Discussion

The sixth rule (§1002.7(e)) with respect to "insurance," simply prohibits a creditor from either: refusing to extend credit; and terminating an account; because credit life, health, accident, disability, or other credit-related insurance is not available on the basis of the applicant's age.

The commentary provides safe harbor for *differences in terms* and *use of insurance information*.

Regulatory Text

(e) **Insurance.** A creditor shall not refuse to extend credit and shall not terminate an account because credit life, health, accident, disability, or other credit-related insurance is not available on the basis of the applicant's age.

Regulatory Commentary

7(e) Insurance.

1. ***Differences in terms.*** *Differences in the availability, rates, and other terms on which credit-related casualty insurance or credit life, health, accident, or disability insurance is offered or provided to an applicant does not violate Regulation B.*

2. ***Insurance information.*** *A creditor may obtain information about an applicant's age, sex, or marital status for insurance purposes. The information may only be used for determining eligibility and premium rates for insurance, however, and not in making the credit decision*

Section 6: Audit of Account Opening

Technique

This section is a audit of how the loan was actually opened.

Questions

Individual Accounts

- Did the bank appropriately grant credit in an individual's name as requested?

Designation of Name

- Did the bank allow an applicant to open or maintain an account in a birth-given first name and a surname that is the applicant's birth-given surname, the spouse's surname, or a combined surname?

Signature of Spouse or Other Person

- Did the bank follow all signature related rules, including:
    - rule for qualified applicant
    - secured credit
    - additional parties
    - rights of additional parties

Insurance

- Did the appropriately ignore any questions that were asked for the purpose of insurance?

Section 7: Notifications
12 CFR § 1002.9

Introductory Commentary – 12 CFR § 1002.9

Regulatory Discussion

There are seven paragraphs, (a) through (g) which will be discussed in this Section.

The introductory commentary provides guidance on five topics: *use of the term "adverse action*;" treatment of *withdrawn applications*; determining *when "notification" occurs*; *location of the "notice;"* and treatment of *prequalification requests*.

Regulatory Text

None.

Regulatory Commentary

1. ***Use of the term adverse action.*** *The regulation does not require that a creditor use the term adverse action in communicating to an applicant that a request for an extension of credit has not been approved. In notifying an applicant of adverse action as defined by §1002.2(c)(1), a creditor may use any words or phrases that describe the action taken on the application.*
2. ***Expressly withdrawn applications.*** *When an applicant expressly withdraws a credit application, the creditor is not required to comply with the notification requirements under §1002.9. (The creditor must comply, however, with the record retention requirements of the regulation. See §1002.12(b)(3).)*
3. ***When notification occurs.*** *Notification occurs when a creditor delivers or mails a notice to the applicant's last known address or, in the case of an oral notification, when the creditor communicates the credit decision to the applicant.*
4. ***Location of notice.*** *The notifications required under §1002.9 may appear on either or both sides of a form or letter.*
5. ***Prequalification requests.*** *Whether a creditor must provide a notice of action taken for a prequalification request depends on the creditor's response to the request, as discussed in comment 2(f)-3. For instance, a creditor may treat the request as an inquiry if the creditor evaluates specific information about the consumer and tells the consumer the loan amount, rate, and other terms of credit the consumer could qualify for under various loan programs, explaining the process the consumer must follow to submit a mortgage application and the information the creditor will analyze in reaching a credit decision. On the other hand, a creditor has treated a request as an application, and is subject to the adverse action notice requirements of §1002.9 if, after evaluating information, the creditor decides that it will not approve the request and communicates that decision to the consumer. For example, if the creditor tells the consumer that it would not approve an application for a mortgage because of a bankruptcy in the consumer's record, the creditor has denied an application for credit.*

Notification of Action Taken (When Notification Required) – 12 CFR §1002.9(a)(1)

Regulatory Discussion

Paragraph (a)(1) under §1002.9 requires a creditor to notify an applicant of *action taken* within the following specific timeframes:

- Within 30 days after receiving a completed application;
  - See the commentary for guidance on: *timing of notice - when an application is complete;* and *notification of approval*.
- Within 30 days after taking adverse action on an incomplete application;
  - See paragraph (c) for *notice alternatives* on incomplete applications.
  - See the commentary for guidance on: *incomplete application - denial for incompleteness* and *denial for reasons other than incompleteness*.
- Within 30 days after taking adverse action on an existing account; or
- Within 90 days after notification of a counteroffer if the applicant neither accepts nor uses the credit offered
  - See the commentary for guidance on: *length of counteroffer;* and *counteroffer combined with adverse action notice*.

Notification occurs when a creditor delivers or mails a notice to the applicant's last known address. In the case of an oral notification, notification occurs when the creditor communicates the credit decision to the applicant.

Note the commentary on *denial of a telephone application*. When an application is made by telephone and adverse action is taken, the creditor must request the applicant's name and address in order to provide written notification under this section. If the applicant declines to provide that information, then the creditor has no further notification responsibility.

Regulatory Text

(a) **Notification of action taken, ECOA notice, and statement of specific reasons**

(1) **When notification is required.** A creditor shall notify an 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.

Regulatory Commentary

9(a) Notification of action taken, ECOA notice, and statement of specific reasons.

Paragraph 9(a)(1).

1. ***Timing of notice - when an application is complete.*** *Once a creditor has obtained all the information it normally considers in making a credit decision, the application is complete and the creditor has 30 days in which to notify the applicant of the credit decision. (See also comment 2(f)-6.)*

2. ***Notification of approval.*** *Notification of approval may be express or by implication. For example, the creditor will satisfy the notification requirement when it gives the applicant the credit card, money, property, or services requested.*

3. ***Incomplete application - denial for incompleteness.*** *When an application is incomplete regarding information that the applicant can provide and the creditor lacks sufficient data for a credit decision, the creditor may deny the application giving as the reason for denial that the application is incomplete. The creditor has the option, alternatively, of providing a notice of incompleteness under §1002.9(c).*

4. ***Incomplete application - denial for reasons other than incompleteness.*** *When an application is missing information but provides sufficient data for a credit decision, the creditor may evaluate the application, make its credit decision, and notify the applicant accordingly. If credit is denied, the applicant must be given the specific reasons for the credit denial (or notice of the right to receive the reasons); in this instance missing information or "incomplete application" cannot be given as the reason for the denial.*

5. ***Length of counteroffer.*** *Section 1002.9(a)(1)(iv) does not require a creditor to hold a counteroffer open for 90 days or any other particular length of time.*

6. ***Counteroffer combined with adverse action notice.*** *A creditor that gives the applicant a combined counteroffer and adverse action notice that complies with §1002.9(a)(2) need not send a second adverse action notice if the applicant does not accept the counteroffer. A sample of a combined notice is contained in form C-4 of appendix C to the regulation.*

7. ***Denial of a telephone application.*** *When an application is made by telephone and adverse action is taken, the creditor must request the applicant's name and address in order to provide written notification under this section. If the applicant declines to provide that information, then the creditor has no further notification responsibility.*

Notification of Action Taken (Content) – 12 CFR §1002.9(a)(2)

Regulatory Discussion

Paragraph (a)(2) under §1002.9 requires the *notice of adverse action to be in writing* and must include the following information:

- A statement of the action taken;
- The name and address of the creditor;
- A statement of the provisions of 701(a) of the ECOA (see §1002.9(b)(1));
- The name and address of the creditor's Federal supervisory agency (see Appendix A);

***and either*:**

- A statement of specific reasons for the action taken; *or*
- A disclosure of the applicant's right to a statement of specific reasons.

The Dodd-Frank Act amended section 615(a) of the FCRA to require that creditors disclose additional information on FCRA adverse action notices. The statute generally requires that a FCRA adverse action notice include:

- a numerical credit score used in making the credit decision;
- the range of possible scores under the model used;
- up to four key factors that adversely affected the consumer's credit score (or up to five factors if the number of inquiries made with respect to that consumer report is a key factor);
- the date on which the credit score was created; and
- the name of the person or entity that provided the credit score.

Model Notices C-1 Through C-5

Model notices C-1 through C-5 may be used to comply with the adverse action provisions of both the ECOA and the FCRA. The Board amended these notices to incorporate the additional content requirements prescribed by the Dodd-Frank Act.

Contact Information for the Entity that Provided the Credit Score

The Board added optional language to the model forms that creditors may use to direct the consumer to the entity (which may be a consumer reporting agency or the creditor itself, for a proprietary score that meets the definition of a credit score) that provided the credit score for any questions about the credit score, along with the entity's contact information. Because this language is optional, creditors may use or not use the additional language without losing the safe harbor provided under Regulation B and the ECOA. Paragraph 2 of Appendix C is revised to clarify that the disclosure of the entity's contact information is optional.

Use of a Credit Score

In some cases, a creditor that is required to provide an adverse action notice under the FCRA may use a consumer report, but not a credit score, in taking the adverse action. The Dodd-Frank Act requires disclosure if a credit score was used in taking adverse action. A creditor that obtains a credit score and takes adverse action is required to disclose that score, unless the credit score played no role in the adverse action determination. If the credit score was a factor in the adverse action decision, even if it was not a significant factor, the creditor will have used the credit score for purposes of the regulation.

Disclosure that No Credit Score is Available

In some cases, a creditor may try to obtain a credit score for an applicant, but the applicant may have insufficient credit history for the consumer-reporting agency to generate a credit score. This change only applies when a creditor uses a credit score in taking adverse action. The creditor cannot disclose credit score information if an applicant has no credit score. Nothing in the Dodd-Frank Act prevents a creditor, however, from providing the applicant notice that no credit score was available from a consumer-reporting agency, although this is not required.

Key Factors

The Dodd-Frank Act expressly requires disclosure of the top key factors that adversely affected the credit score, whether or not the effect was substantial. A person taking adverse action must provide the consumer the required information. The FCRA requires disclosure of all of the key factors that adversely affected the credit score in the model used, up to four, subject to the FCRA, which states that if the key factors that adversely affected the credit score include the number of inquiries made with respect to the consumer report, the "number of inquiries" must be disclosed as a key factor.

The person taking adverse action is responsible for providing the credit score disclosure, including the key factors adversely affecting the credit score. If a creditor is using a credit score purchased from a consumer-reporting agency, the consumer-reporting agency is in the best position to identify the key factors that affected the score, and the creditor could rely on that information in its disclosure to consumers. Contractual arrangements between creditors and consumer reporting agencies may vary as to how creditors will receive the credit score information necessary to comply. The imposition of requirements on consumer reporting agencies is not within the scope of this rulemaking under the ECOA.

Disclosing Credit Score Information on a Separate Document

The FCRA requires a creditor to provide notice of adverse action to consumers against whom it takes adverse action based in whole or in part on information contained in a consumer report. The Dodd-Frank Act amended FCRA to require a creditor to provide such consumers credit score information. Providing a form with credit score information separately from an adverse action notice does not appear to be consistent with the legislation.

Co-applicants

Section 1002.9(f) of Regulation B permits a creditor to provide an adverse action notice to only one applicant, and requires a creditor to provide an adverse action notice to the primary applicant, when a primary applicant is readily apparent. In contrast, section 615(a) of the FCRA requires a creditor to provide the disclosures mandated by that section to “any consumer” against whom adverse action is taken, if the adverse action is based in whole or in part on information from a consumer report. The FCRA’s reference to “any consumer” would seem to include co-applicants. Given privacy and customer relations concerns, creditors would generally provide separate FCRA adverse action notices to each applicant with only the individual’s credit score on each notice.

Guarantors and Co-Signers

An application may involve a guarantor or co-signer. Under Regulation B, only an applicant can experience adverse action. Further, a guarantor or co-signer is not deemed an applicant. The FCRA provides that adverse action has the same meaning for purposes of the FCRA as is provided in the ECOA and Regulation B in the context of a credit application. Therefore, a guarantor or co-signer would not receive an adverse action notice under the ECOA or the FCRA. The credit applicant would, however, receive an adverse action notice, even if the adverse action decision is made solely based on information in the guarantor’s or co-signer’s consumer report.

The Dodd-Frank Act does not address whether, in this circumstance, the adverse action notice received by an applicant under the FCRA should include a guarantor or co-signer’s credit score. However, there is no intent that an individual receive another individual’s credit score. The FCRA associates a credit score with a particular individual. A guarantor or co-signer’s credit score should not be disclosed to an applicant in an adverse action notice.

Multiple Scores

Some creditors may obtain multiple credit scores from consumer reporting agencies in connection with their underwriting processes. A creditor may use one or more of those scores in taking adverse action. The Dodd-Frank Act only requires a person to disclose a single credit score used in taking adverse action.

When a creditor obtains multiple scores but only uses one in making the decision, the creditor must disclose the credit score that it used. The Dodd-Frank Act does not specify what credit score should be disclosed in such cases, but only requires a person to disclose a single credit score that is used by the person in making the credit decision. A creditor would comply with the statute by disclosing any of the credit scores that it used. Creditors should have policies and procedures to determine which of the multiple credit scores was used in taking adverse action. For instance, a creditor could have policies and procedures specifying that:

- when the creditor obtains or creates multiple credit scores but only uses one of those credit scores in taking adverse action, for example, by using the low, middle, high, or most recent score, the creditor would disclose that credit score and information relating to that credit score; and

- when a creditor uses multiple credit scores in taking adverse action, for example, by computing the average of all the credit scores obtained, the creditor would disclose any one of those credit scores and information relating to the credit score.

Because credit-scoring models may differ considerably in nature and the range of scores used, consumers would not necessarily benefit if they receive and try to compare multiple scores. Disclosing multiple credit scores could confuse consumers who do not understand the differences, which might lessen the value of the disclosures. Moreover, the Dodd-Frank Act requires the Consumer Financial Protection Bureau (CFPB) to conduct a study of the different credit scoring systems, and whether these variations disadvantage consumers. The CFPB's study might develop a record that could serve as the basis for reconsidering this issue in a future rulemaking.

Adverse Actions Not Limited to Credit

Section 1002.2(c) of the ECOA limits the definition of adverse action to decisions regarding credit. The FCRA, however, does not include such a limitation. The FCRA therefore applies to adverse action decisions related to credit, but also decisions regarding, for example, a deposit account, insurance product, or employment. Although a credit score may generally be used in making or arranging loans, a credit score may also be used in taking adverse action not related to credit. A person would need to disclose a credit score obtained from a consumer reporting agency as part of the adverse action notice as set forth in the Dodd Frank Act, even if the person used the credit score to take adverse action for a non-lending product. In requiring credit score disclosures, the Dodd-Frank Act does not state that the credit score disclosures are only required for adverse action decisions related to credit.

FORM C-1—SAMPLE NOTICE OF ACTION TAKEN AND STATEMENT OF REASONS
Statement of Credit Denial, Termination or Change

Date: ____________________

Applicant's Name: ____________________
Applicant's Address:____________________
Description of Account, Transaction, or Requested Credit: ____________________
Description of Action Taken:____________________

Part I – PRINCIPAL REASON(S) FOR CREDIT DENIAL, TERMINATION, OR OTHER ACTION TAKEN CONCERNING CREDIT.

This section must be completed in all instances.

____________________Credit application incomplete
____________________Insufficient number of credit references provided
____________________Unacceptable type of credit references provided
____________________Unable to verify credit references
____________________Temporary or irregular employment
____________________Unable to verify employment
____________________Length of employment
____________________Income insufficient for amount of credit requested
____________________Excessive obligations in relation to income
____________________Unable to verify income
____________________Length of residence
____________________Temporary residence
____________________Unable to verify residence
____________________No credit file
____________________Limited credit experience
____________________Poor credit performance with us
____________________Delinquent past or present credit obligations with others
____________________Collection action or judgment
____________________Garnishment or attachment
____________________Foreclosure or repossession
____________________Bankruptcy
____________________ Number of recent inquiries on credit bureau report
____________________Value or type of collateral not sufficient
____________________Other, specify:____________________

Part II— DISCLOSURE OF USE OF INFORMATION OBTAINED FROM AN OUTSIDE SOURCE.

This section should be completed if the credit decision was based in whole or in part on information that has been obtained from an outside source.

____________________Our credit decision was based in whole or in part on information obtained in a report from the consumer-reporting agency listed below. You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer-reporting agency. The reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. You also have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency.

Name:____________________
Address: ____________________
[Toll-free] Telephone number: ____________________

___ [We also obtained your credit score from this Consumer-reporting agency and used it in making our credit decision. Your credit score is a number that reflects the information in your consumer report. Your credit score can change, depending on how the information in your consumer report changes.

Your credit score: ____________________

Date: ____________________

Scores range from a low of ______________ to a high of _______________

Key factors that adversely affected your credit score:

____

____

____

____

[Number of recent inquiries on consumer report, as a key factor]

[If you have any questions regarding your credit score, you should contact [entity that provided the credit score] at:

Address: ____

____

[Toll-free] Telephone number:____]]

____Our credit decision was based in whole or in part on information obtained from an affiliate or from an outside source other than a consumer reporting agency. Under the Fair Credit Reporting Act, you have the right to make a written request, no later than 60 days after you receive this notice, for disclosure of the nature of this information.

If you have any questions regarding this notice, you should contact:
Creditor's name:____________________
Creditor's address:____________________
Creditor's telephone number:____________________

NOTICE

The Federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in appendix A).

Regulatory Text

(a) **Notification of action taken, ECOA notice, and statement of specific reasons**

(2) **Content of notification when adverse action is taken.** A notification given to an applicant when adverse action is taken shall be in writing and shall contain a statement of the action taken; the name and address of the creditor; a statement of the provisions of section 701(a) of the Act; the name and address of the Federal agency that administers compliance with respect to the creditor; and either:

(i) A statement of specific reasons for the action taken; or

(ii) A disclosure of the applicant's right to a statement of specific reasons within 30 days, if the statement is requested within 60 days of the creditor's notification. The disclosure shall include the name, address, and telephone number of the person or office from which the statement of reasons can be obtained. If the creditor chooses to provide the reasons orally, the creditor shall also disclose the applicant's right to have them confirmed in writing within 30 days of receiving the applicant's written request for confirmation.

Regulatory Commentary

None.

Notification of Action Taken (Business Applicants) – 12 CFR §1002.9(a)(3)

Regulatory Discussion

Omitted.

Form of ECOA Notice – 12 CFR §1002.9(b)(1)

Regulatory Discussion

Paragraph (b)(1) under §1002.9 simple provides the ECOA notice content required in paragraph (a)(2).

Regulatory Text

(b) **Form of ECOA notice and statement of specific reasons**

(1) *ECOA notice*. To satisfy the disclosure requirements of paragraph (a)(2) of this section regarding section 701(a) of the Act, the creditor shall provide a notice that is

substantially similar to the following: The Federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is [name and address as specified by the appropriate agency or agencies listed in appendix A of this part].

Until January 1, 2013, a creditor may comply with this paragraph (b)(1) and paragraph (a)(2) of this section by including in the notice the name and address as specified by the appropriate agency in appendix A to 12 CFR part 202, as in effect on October 1, 2011.

Regulatory Commentary

9(b) Form of ECOA notice and statement of specific reasons.

Paragraph 9(b)(1).

1. ***Substantially similar notice.*** *The ECOA notice sent with a notification of a credit denial or other adverse action will comply with the regulation if it is "substantially similar" to the notice contained in §1002.9(b)(1). For example, a creditor may add a reference to the fact that the ECOA permits age to be considered in certain credit scoring systems, or add a reference to a similar state statute or regulation and to a state enforcement agency.*

Statement of Specific Reasons – 12 CFR §1002.9(b)(2)

Regulatory Discussion

Paragraph (b)(2) under §1002.9 requires the statement of reasons for adverse action *be specific and indicate the principal reason(s)* for the adverse action.

The commentary provides significant information on the following topics:

- *Number of specific reasons*: more than four is not likely to be helpful to the applicant.
- *Source of specific reasons*: must relate to and accurately describe the factors considered or scored.
- *Description of specific reasons*: need not describe how or why a factor adversely affected an applicant.
- *Credit scoring system*: if used, the reasons disclosed must relate only to those factors actually scored.
- *Credit scoring – method for selecting reasons*: various methods may be used for selecting reasons for a credit denial or other adverse action that is based on a credit scoring system.

- *Judgmental system*: if used, the reasons for the denial or other adverse action must relate to those factors in the applicant's record actually reviewed by the person making the decision.
- *Combined credit scoring and judgmental system*: if used, the reasons for the denial must come from the component of the system that the applicant failed.
- *Automatic denial*: if used, the creditor must disclose that specific factor.
- *Combined ECOA-FCRA disclosures*:

The ECOA requires disclosure of the principal reasons for denying or taking other adverse action on an application for an extension of credit. The Fair Credit Reporting Act (FCRA) requires a creditor to disclose when it has based its decision in whole or in part on information from a source other than the applicant or its own files.

- Disclosing that a credit report was obtained and used in the denial of the application, as the FCRA requires, does not satisfy the ECOA requirement to disclose specific reasons.
- For example, if the applicant's credit history reveals delinquent credit obligations and the application is denied for that reason, to satisfy §1002.9(b)(2) the creditor must disclose that the application was denied because of the applicant's delinquent credit obligations.

The FCRA also requires a creditor to disclose, as applicable, a credit score it used in taking adverse action along with related information, including up to four key factors that adversely affected the consumer's credit score (or up to five factors if the number of inquiries made with respect to that consumer report is a key factor).

- Disclosing the key factors that adversely affected the consumer's credit score does not satisfy the ECOA requirement to disclose specific reasons for denying or taking other adverse action on an application or extension of credit.

Sample forms C-1 through C-5 of appendix C of the regulation provide for both the ECOA and FCRA disclosures. See also comment 9(b)(2)-1.

Regulatory Text

(b) **Form of ECOA notice and statement of specific reasons**

(2) **Statement of specific reasons.** The statement of reasons for adverse action required by paragraph (a)(2)(i) of this section must be specific and indicate the principal reason(s) for the adverse action. Statements that the adverse action was based on the creditor's internal standards or policies or that the applicant, joint applicant, or similar party failed to achieve a qualifying score on the creditor's credit scoring system are insufficient.

Regulatory Commentary

Paragraph 9(b)(2).

*1. **Number of specific reasons.** A creditor must disclose the principal reasons for denying an application or taking other adverse action. 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.*

2. ***Source of specific reasons.*** *The specific reasons disclosed under §§1002.9(a)(2) and (b)(2) must relate to and accurately describe the factors actually considered or scored by a creditor.*

3. ***Description of reasons.*** *A creditor need not describe how or why a factor adversely affected an applicant. For example, the notice may say "length of residence" rather than "too short a period of residence."*

4. ***Credit scoring system.*** *If a creditor bases the denial or other adverse action on a credit scoring system, the reasons disclosed must relate only to those factors actually scored in the system. Moreover, no factor that was a principal reason for adverse action may be excluded from disclosure. The creditor must disclose the actual reasons for denial (for example, "age of automobile") even if the relationship of that factor to predicting creditworthiness may not be clear to the applicant.*

5. ***Credit scoring - method for selecting reasons.*** *The regulation does not require that any one method be used for selecting reasons for a credit denial or other adverse action that is based on a credit scoring system. Various methods will meet the requirements of the regulation. One method is to identify the factors for which the applicant's score fell furthest below the average score for each of those factors achieved by applicants whose total score was at or slightly above the minimum passing score. Another method is to identify the factors for which the applicant's score fell furthest below the average score for each of those factors achieved by all applicants. These average scores could be calculated during the development or use of the system. Any other method that produces results substantially similar to either of these methods is also acceptable under the regulation.*

6. ***Judgmental system.*** *If a creditor uses a judgmental system, the reasons for the denial or other adverse action must relate to those factors in the applicant's record actually reviewed by the person making the decision.*

7. ***Combined credit scoring and judgmental system.*** *If a creditor denies an application based on a credit evaluation system that employs both credit scoring and judgmental components, the reasons for the denial must come from the component of the system that the applicant failed. For example, if a creditor initially credit scores an application and denies the credit request as a result of that scoring, the reasons disclosed to the applicant must relate to the factors scored in the system. If the application passes the credit scoring stage but the creditor then denies the credit request based on a judgmental assessment of the applicant's record, the reasons disclosed must relate to the factors reviewed judgmentally, even if the factors were also considered in the credit scoring component. If the application is not approved or denied as a result of the credit scoring, but falls into a gray band, and the creditor performs a judgmental assessment and denies the credit after that assessment, the reasons disclosed must come from both components of the system. The same result applies where a judgmental assessment is the first component of the combined system. As provided in comment 9(b)(2)-1, disclosure of more than a combined total of four reasons is not likely to be helpful to the applicant.*

8. ***Automatic denial.*** *Some credit decision methods contain features that call for automatic denial because of one or more negative factors in the applicant's record (such as the applicant's previous bad credit history with that creditor, the applicant's declaration of bankruptcy, or the fact that the applicant is a minor). When a creditor denies the credit request because of an automatic-denial factor, the creditor must disclose that specific factor.*

*9. **Combined ECOA-FCRA disclosures.** The ECOA requires disclosure of the principal reasons for denying or taking other adverse action on an application for an extension of credit. The Fair Credit Reporting Act (FCRA) requires a creditor to disclose when it has based its decision in whole or in part on information from a source other than the applicant or its own files. Disclosing that a credit report was obtained and used in the denial of the application, as the FCRA requires, does not satisfy the ECOA requirement to disclose specific reasons. For example, if the applicant's credit history reveals delinquent credit obligations and the application is denied for that reason, to satisfy §1002.9(b)(2) the creditor must disclose that the application was denied because of the applicant's delinquent credit obligations. The FCRA also requires a creditor to disclose, as applicable, a credit score it used in taking adverse action along with related information, including up to four key factors that adversely affected the consumer's credit score (or up to five factors if the number of inquiries made with respect to that consumer report is a key factor). Disclosing the key factors that adversely affected the consumer's credit score does not satisfy the ECOA requirement to disclose specific reasons for denying or taking other adverse action on an application or extension of credit. Sample forms C-1 through C-5 of appendix C of the regulation provide for both the ECOA and FCRA disclosures. See also comment 9(b)(2)-1.*

Incomplete Application (Notice Alternatives) – 12 CFR §1002.9(c)(1)

Regulatory Discussion

Paragraph (c)(1) under §1002.9 provides an alternative to the notice of action taken as described in paragraph (a)(1)(ii). The alternative “notice of incompleteness” is discussed in paragraph (c)(2).

Note the commentary does not allow use of the “notice of incompleteness” for preapprovals.

Regulatory Text

(c) **Incomplete applications**

(1) **Notice alternatives.** Within 30 days after receiving an application that is incomplete regarding matters that an applicant can complete, the creditor shall notify the applicant either:

(i) Of action taken, in accordance with paragraph (a) of this section; or

(ii) Of the incompleteness, in accordance with paragraph (c)(2) of this section.

Regulatory Commentary

9(c) Incomplete applications.

Paragraph 9(c)(1).

1. ***Exception for preapprovals.*** *The requirement to provide a notice of incompleteness does not apply to preapprovals that constitute applications under §1002.2(f).*

Incomplete Application (Notice of Incompleteness) – 12 CFR §1002.9(c)(2)

Regulatory Discussion

Paragraph (c)(2) under §1002.9 provides the process for using the "notice of incompleteness" instead of using the notice of action taken described in paragraph (a)(1)(ii). The process to be followed is:

- If additional information is needed, the creditor shall send a *written notice*:
    - specifying the information needed,
    - designating a reasonable period of time for the applicant to provide the information, and
    - informing the applicant that failure to provide the information requested will result in no further consideration being given to the application.
- The creditor shall have no further obligation if the applicant fails to respond within the designated time period.
- If the applicant supplies the requested information within the designated time period, the creditor shall take action on the application and notify the applicant in accordance with paragraph (a).

The commentary provides guidance on when a new application may be required.

Regulatory Text

(c) **Incomplete applications**

(2) **Notice of incompleteness.** If additional information is needed from an applicant, the creditor shall send a written notice to the applicant specifying the information needed, designating a reasonable period of time for the applicant to provide the information, and informing the applicant that failure to provide the information requested will result in no further consideration being given to the application. The creditor shall have no further obligation under this section if the applicant fails to respond within the designated time period. If the applicant supplies the requested information within the designated time period, the creditor shall take action on the application and notify the applicant in accordance with paragraph (a) of this section.

Regulatory Commentary

9(c) Incomplete applications.

Paragraph 9(c)(2).

1. ***Reapplication.*** *If information requested by a creditor is submitted by an applicant after the expiration of the time period designated by the creditor, the creditor may require the applicant to make a new application.*

Incomplete Application (Oral Request for Information) – 12 CFR §1002.9(c)(3)

Regulatory Discussion

Paragraph (c)(3) under §1002.9 provides another option to *orally inform* the applicant of the need for additional information. If this option is chose, and the application remains incomplete, the creditor must send a notice of action taken according to paragraph (c)(1) – kind of like a "round robin game!"

Regulatory Text

(c) **Incomplete applications**

(3) **Oral request for information.** At its option, a creditor may inform the applicant orally of the need for additional information. If the application remains incomplete, the creditor shall send a notice in accordance with paragraph (c)(1) of this section.

Regulatory Commentary

9(c) Incomplete applications.

Paragraph 9(c)(3).

1. ***Oral inquiries for additional information.*** *If an applicant fails to provide the information in response to an oral request, a creditor must send a written notice to the applicant within the 30-day period specified in §§1002.9(c)(1) and (2). If the applicant provides the information, the creditor must take action on the application and notify the applicant in accordance with §1002.9(a).*

Oral Notifications by Small-Volume Creditors – 12 CFR §1002.9(d)

Regulatory Discussion

Paragraph (d) under §1002.9 allows a creditor, with 150 or fewer applications received during the preceding calendar year, the option to provide oral notice of action taken.

Regulatory Text

(d) **Oral notifications by small-volume creditors**. In the case of a creditor that did not receive more than 150 applications during the preceding calendar year, the requirements of this section (including statements of specific reasons) are satisfied by oral notifications.

Regulatory Commentary

None.

Withdrawal of Approved Application – 12 CFR §1002.9(e)

Regulatory Discussion

In the event an application is approved and the applicant has not inquired within 30 days, paragraph (e) under §1002.9 allows the creditor to treat the application as "withdrawn" and need not comply with the notice of action taken requirements in paragraph (a)(1).

When an applicant expressly withdraws a credit application, a creditor is not required to comply with the notification requirements of the regulation. The creditor must, however, comply with the record-retention requirements of the regulation.

Regulatory Text

(e) **Withdrawal of approved application.** When an applicant submits an application and the parties contemplate that the applicant will inquire about its status, if the creditor approves the application and the applicant has not inquired within 30 days after applying, the creditor may treat the application as withdrawn and need not comply with paragraph (a)(1) of this section.

Regulatory Commentary

None.

Multiple Applicants – 12 CFR §1002.9(f)

Regulatory Discussion

In the event an application involves more than one applicant, paragraph (f) under §1002.9 provides that the notice of action taken need only be given to the "primary applicant" (where one is readily apparent).

According to the FRB, there is no expectation of privacy between co-applicants or applicants and guarantors. One statement of reasons for adverse action that combines any negative information about the multiple parties is permissible.

NOTE: the FCRA differs on who must receive the notice of action taken when there are multiple applicants. The second quarter 2013 FRB Consumer Compliance Outlook (page 19) provides the following:

"In the case of multiple applicants under the FCRA, the statute has been interpreted to require notice to all consumers against whom adverse action is taken if the action taken was based information in a consumer report. If the applicants' credit scores were used in taking adverse action, each individual should receive a separate adverse action notice with the credit score and related disclosures associated with his or her individual consumer report; however, an applicant should not receive credit score information about a co-applicant. Regulation B does not prohibit delivery of an adverse action notice to each applicant. If applicable, financial institutions can provide a combined notice of adverse action to all consumer applicants to comply with multiple-applicant requirements under the FCRA, provided a credit score is not required for the adverse action notice because a score was not relied upon in taking adverse action."

Regulatory Text

(f) **Multiple applicants.** When an application involves more than one applicant, notification need only be given to one of them but must be given to the primary applicant where one is readily apparent.

Regulatory Commentary

None.

Applications Submitted Through a Third Party – 12 CFR §1002.9(g)

Regulatory Discussion

In the event an application is submitted, by a third party, to more than one creditor, paragraph (g) under §1002.9 provides the following:

- If the applicant expressly accepts or uses credit offered by one of the creditors, notification of action taken by any of the other creditors is not required.

- If no credit is offered, or if the applicant does not expressly accept or use the credit offered, each creditor taking adverse action must provide a notice of action taken, directly or through a third party.
    - o A notice of action taken given by a third party shall disclose the identity of each creditor on whose behalf the notice is given.

The commentary provides additional guidance.

Regulatory Text

(g) **Applications submitted through a third party.** When an application is made on behalf of an applicant to more than one creditor and the applicant expressly accepts or uses credit offered by one of the creditors, notification of action taken by any of the other creditors is not required. If no credit is offered or if the applicant does not expressly accept or use the credit offered, each creditor taking adverse action must comply with this section, directly or through a third party. A notice given by a third party shall disclose the identity of each creditor on whose behalf the notice is given.

Regulatory Commentary

9(g) Applications submitted through a third party.

*1. **Third parties.** The notification of adverse action may be given by one of the creditors to whom an application was submitted, or by a noncreditor third party. If one notification is provided on behalf of multiple creditors, the notice must contain the name and address of each creditor. The notice must either disclose the applicant's right to a statement of specific reasons within 30 days, or give the primary reasons each creditor relied upon in taking the adverse action—clearly indicating which reasons relate to which creditor.*

*2. **Third party notice - enforcement agency.** If a single adverse action notice is being provided to an applicant on behalf of several creditors and they are under the jurisdiction of different Federal enforcement agencies, the notice need not name each agency; disclosure of any one of them will suffice.*

*3. **Third-party notice - liability.** When a notice is to be provided through a third party, a creditor is not liable for an act or omission of the third party that constitutes a violation of the regulation if the creditor accurately and in a timely manner provided the third party with the information necessary for the notification and maintains reasonable procedures adapted to prevent such violations.*

Appendix A to Part 1002—Federal Agencies to be Listed in Adverse Action Notices

The following list indicates the Federal agency or agencies that should be listed in notices provided by creditors pursuant to §1002.9(b)(1). Any questions concerning a particular creditor may be directed to such agencies. This list is not intended to describe agencies' enforcement authority for ECOA and Regulation B. Terms that are not defined in the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the meaning given to them in the International Banking Act of 1978 (12 U.S.C. 3101).

1. **Banks, savings associations, and credit unions with total assets of over $10 billion and their affiliates:** Bureau of Consumer Financial Protection, 1700 G Street NW., Washington DC 20006. Such affiliates that are not banks, savings associations, or credit unions also should list, in addition to the Bureau: FTC Regional Office for region in which the creditor operates or Federal Trade Commission, Equal Credit Opportunity, Washington, DC 20580.

2. To the extent not included in item 1 above:

    a. **National banks, Federal savings associations, and Federal branches and Federal agencies of foreign banks:** Office of the Comptroller of the Currency, Customer Assistance Group, 1301 McKinney Street, Suite 3450, Houston, TX 77010-9050

    b. **State member banks, branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act:** Federal Reserve Consumer Help Center, P.O. Box 1200, Minneapolis, MN 55480.

    c. **Nonmember Insured Banks, Insured State Branches of Foreign Banks, and Insured State Savings Associations:** FDIC Consumer Response Center, 1100 Walnut Street, Box #11, Kansas City, MO 64106.

    d. **Federal Credit Unions:** Omitted

3. **Air carriers:** Omitted.

4. **Creditors Subject to Surface Transportation Board:** Omitted.

5. **Creditors Subject to Packers and Stockyards Act:** Omitted.

6. **Small Business Investment Companies:** Omitted.

7. **Brokers and Dealers:** Omitted.

8. **Federal Land Banks, Federal Land Bank Associations, Federal Intermediate Credit Banks, and Production Credit Associations:** Omitted.

9. **Retailers, Finance Companies, and All Other Creditors Not Listed Above:** Omitted.

Section 8: Denial Checklist

Technique

As denials can be very technical and detailed, we have chosen to provide a general denied application checklist. Feel free to add any additional questions that may be relevant in your bank.

The Checklist

Denied Application Checklist

Audit Date ____________________

Reviewer ____________________

Loan Officer ____________________

Applicant(s) ____

Appl. Date ____________________ Denial Date________________________

Type of Loan Request____

Answer all questions below Yes, No, N/A

1. Written application obtained? _____________
2. Application completed appropriately for the type of credit requested? ______________
3. Only gender-neutral terms used regarding applicant(s)? _____________
4. Application signed? _____________
5. Application dated? ______________
6. Government monitoring information obtained and recorded? _____________
7. Copy of the appraisal or the notice of availability given? Note: Separate notice is required if denial was prior to the issuance of an LE. ______________

8. Denial notice mailed or delivered within 30 days after application? ____________
9. Denial notice describe the credit request? ____________
10. Denial notice describe the action taken? ______________
11. Denial notice state the specific reasons (maximum of four) for denial? ________
12. Credit bureau disclosure given? ____________
13. Denial notice state bank's name and address? ____________
14. Federal regulatory agency's name and address given on the denial? ____________

Additional Comments:

Section 9: Rules on Providing Appraisals and Other Valuations

12 CFR §1002.14

Providing Appraisals and Valuations – 12 CFR § 1002.14(a)

Regulatory Discussion

The Bureau of Consumer Financial Protection (CFPB) amended Regulation B and the CFPB's official interpretations of the regulation, to implement the amendment that was enacted as part of the Dodd-Frank Act. The revisions require creditors to provide to applicants free copies of all appraisals and other written valuations developed in connection with an application for a loan to be secured by a first lien on a dwelling, and require creditors to notify applicants in writing that copies of appraisals will be provided to them promptly.

There are four main elements:

- Requires creditors to notify applicants within three business days of receiving an application of their right to receive a copy of appraisals used in connection with the application.
- Requires creditors to provide applicants a copy of each appraisal and other written valuation promptly upon its completion or three business days before consummation (for closed-end credit) or account opening (for open-end credit), whichever is earlier.
- Permits applicants to waive the timing requirement for providing these copies. However, applicants who waive the timing requirement must be given a copy of all appraisals and other written valuations at or prior to consummation or account opening, or, if the transaction is not consummated or the account is not opened, no later than 30 days after the creditor determines the transaction will not be consummated or the account will not be opened.
- Prohibits creditors from charging for the copy of appraisals and other written valuations, but permits creditors to charge applicants reasonable fees for the cost of the appraisals or other written valuations unless applicable law provides otherwise.

Section 14 (§1002.14) includes paragraphs, (a)(1) through (5) and (b)(1) through (3) which will be discussed in this Section.

The introductory commentary provides guidance on providing the appraisal disclosure to multiple applicants.

Regulatory Text

None.

Regulatory Commentary

14(a) Providing appraisals and other valuations.

1. ***Multiple applicants.*** *If there is more than one applicant, the written disclosure about written appraisals, and the copies of appraisals and other written valuations, need only be given to one applicant. However, these materials must be given to the primary applicant where one is readily apparent. Similarly, if there is more than one applicant for credit in the transaction, one applicant may provide a waiver under §1002.14(a)(1), but it must be the primary applicant where one is readily apparent.*

Providing Appraisals and Valuations (In General) – 12 CFR § 1002.14(a)(1)

Regulatory Discussion

In general, a creditor is required to provide a copy of all appraisals (including other written valuations) associated with a credit application that will be secured by a first lien on a dwelling.

- This requirement applies whether the credit is for business or consumer purpose.
- "Dwelling" is defined in paragraph (b)(2) of this section.

In addition, the copy of the appraisal (or other written valuation) must be provided the earlier of:

- Completion, or
- Three business days prior to consummation (closed-end credit), or
- Account opening (open-end credit).

Note: an applicant may waive these timing requirements and agree to receive the copy of the appraisal (or other written valuation) at or before consummation or account opening.

- The waiver generally must be received at least three business days prior to consummation or account opening.

Exceptions:

- If the appraisal (or other written valuation) contains clerical changes from a previous version that was provided to the applicant according to the timing requirements, a new waiver within three business days or account opening is not required.

- If a waiver is provided and the transaction is not consummated or the account is not opened, the copy of the appraisal (or other written valuation) must be provided to the applicant no later than 30 days after it is determined consummation or account opening will not occur.

Creditors must consider whether there is an "applicant" or "application" for an "extension of credit. While some loan modifications can be subject to the provisions of Regulation B, there is variation between different types of loss mitigation programs. The particulars of the program must be considered in evaluating whether there is an application or applicant for an extension of credit within the meaning of Regulation B. Accordingly, if those transactions would otherwise be covered by Regulation B, the requirements of this section would apply.

The commentary provides additional guidance on the following topics:

- When an applicant requests "*renewal"* of an existing credit
- What is meant by "*written*" appraisal or other written valuation
- Discussion on "*timing*" issues including the meaning of "provide," "deliver," and "promptly upon completion." Examples are included for "*promptly upon completion*."
- Discussion of the "*waiver*" requirements
- Discussion of "*multiple versions of appraisals or valuations*"

Regulatory Text

(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. An applicant may waive the timing requirement in this paragraph (a)(1) and agree to receive any copy at or before consummation or account opening, except where otherwise prohibited by law. Any such waiver must be obtained at least three business days prior to consummation or account opening, unless the waiver pertains solely to the applicant's receipt of a copy of an appraisal or other written valuation that contains only clerical changes from a previous version of the appraisal or other written valuation provided to the applicant three or more business days prior to consummation or account opening. If the applicant provides a waiver and the transaction is not consummated or the account is not opened, the creditor must provide these copies no later than 30 days after the creditor determines consummation will not occur or the account will not be opened.

Regulatory Commentary

14(a)(1) In general.

1. ***Coverage.*** *Section 1002.14 covers applications for credit to be secured by a first lien on a dwelling, as that term is defined in §1002.14(b)(2), whether the credit is for a business purpose (for example, a loan to start a business) or a consumer purpose (for example, a loan to purchase a home).*

2. ***Renewals.*** *Section 1002.14(a)(1) applies when an applicant requests the renewal of an existing extension of credit and the creditor develops a new appraisal or other written valuation. Section 1002.14(a)(1) does not apply to the extent a creditor uses the appraisals and other written valuations that were previously developed in connection with the prior extension of credit to evaluate the renewal request.*

3. ***Written.*** *For purposes of §1002.14, an "appraisal or other written valuation" includes, without limitation, an appraisal or other valuation received or developed by the creditor in paper form (hard copy); electronically, such as CD or email; or by any other similar media. See §1002.14(a)(5) regarding the provision of copies of appraisals and other written valuations to applicants via electronic means.*

4. ***Timing.*** *Section 1002.14(a)(1) requires that the creditor "provide" copies of appraisals and other written valuations to the applicant "promptly upon completion," or no later than three business days before consummation (for closed-end credit) or account opening (for open-end credit), whichever is earlier.*

   i. For purposes of this timing requirement, "provide" means "deliver." Delivery occurs three business days after mailing or delivering the copies to the last-known address of the applicant, or when evidence indicates actual receipt by the applicant, whichever is earlier. Delivery to or actual receipt by the applicant by electronic means must comply with the E-Sign Act, as provided for in §1002.14(a)(5).

   ii. The application and meaning of the "promptly upon completion" standard depends upon the facts and circumstances, including but not limited to when the creditor receives the appraisal or other written valuation, and the extent of any review or revision after the creditor receives it.

   iii. "Completion" occurs when the last version is received by the creditor, or when the creditor has reviewed and accepted the appraisal or other written valuation to include any changes or corrections required, whichever is later. See also comment 14(a)(1)-7.

   iv. In a transaction that is being consummated (for closed-end credit) or in which the account is being opened (for open-end credit), if an appraisal or other written valuation has been developed but is not yet complete, the deadline for providing a copy of three business days before consummation or account opening still applies, unless the applicant waived that deadline as provided under §1002.14(a)(1), in which case the copy must be provided at or before consummation or account opening.

   v. Even if the transaction will not be consummated (for closed-end credit) or the account will not be opened (for open-end credit), the copy must be provided "promptly upon completion" as provided for in §1002.14(a)(1), unless the applicant has waived that deadline as provided under §1002.14(a)(1), in which case as provided for in §1002.14(a)(1) the copy *must be provided to the applicant no later than 30 days after the creditor determines the transaction will not be consummated or the account will not be opened.*

5. ***Promptly upon completion - examples.*** *Examples in which the "promptly upon completion" standard would be satisfied include, but are not limited to, those in subparagraphs i, ii, and iii below. Examples in which the "promptly upon completion" standard would not be satisfied include, but are not limited to, those in subparagraphs iv and v below.*

   i. *Sending a copy of an appraisal within a week of completion with sufficient time before consummation (or account opening for open-end credit). On day 15 after receipt of the application, the creditor's underwriting department reviews an appraisal and determines it is acceptable. One week later, the creditor sends a copy of the appraisal to the applicant. The applicant actually receives the copy more than three business days before the date of consummation (or account opening). The creditor has provided the copy of the appraisal promptly upon completion.*

   ii. *Sending a copy of a revised appraisal within a week after completion and with sufficient time before consummation (or account opening for open-end credit). An appraisal is being revised, and the creditor does not receive the revised appraisal until day 45 after the application, when the creditor immediately determines the revised appraisal is acceptable. A week later, the creditor sends a copy of the revised appraisal to the applicant, and does not send a copy of the initial appraisal to the applicant. The applicant actually receives the copy of the revised appraisal three business days before the date of consummation (or account opening). The creditor has provided the appraisal copy promptly upon completion.*

   iii. *Sending a copy of an AVM report within a week after its receipt and with sufficient time before consummation (or account opening for open-end credit). The creditor receives an automated valuation model (AVM) report on day 5 after receipt of the application and treats the AVM report as complete when it is received. On day 12 after receipt of the application, the creditor sends the applicant a copy of the valuation. The applicant actually receives the valuation more than three business days before the date of consummation (or account opening). The creditor has provided the copy of the AVM report promptly upon completion.*

   iv. *Delay in sending an appraisal. On day 12 after receipt of the application, the creditor's underwriting department reviews an appraisal and determines it is acceptable. Although the creditor has determined the appraisal is complete, the creditor waits to provide a copy to the applicant until day 42, when the creditor schedules the consummation (or account opening) to occur on day 50. The creditor has not provided the copy of the appraisal promptly upon completion.*

   v. *Delay in sending an AVM report while waiting for completion of a second valuation. The creditor receives an AVM report on day 5 after application and completes its review of the AVM report the day it is received. The creditor also has ordered an appraisal, but the initial version of the appraisal received by the creditor is found to be deficient and is sent for review. The creditor waits 30 days to provide a copy of the completed AVM report, until the appraisal is completed on day 35. The creditor then provides the applicant with copies of the AVM report and the revised appraisal. While the appraisal report was provided promptly upon completion, the AVM report was not.*

6. ***Waiver.*** *Section 1002.14(a)(1) permits the applicant to waive the timing requirement if the creditor provides the copies at or before consummation or account opening, except where otherwise prohibited by law. Except where otherwise prohibited by law, an applicant's waiver is effective under §1002.14(a)(1) in either of the following two situations:*

   i. *If, no later than three business days prior to consummation or account opening, the applicant provides the creditor an affirmative oral or written statement waiving the timing requirement under this rule; or*

   ii. *If, within three business days of consummation or account opening, the applicant provides the creditor an affirmative oral or written statement waiving the timing requirement under this rule and the waiver pertains solely to the applicant's receipt of a copy of an appraisal or other written valuation that contains only clerical changes from a previous version of the appraisal or other written valuation provided to the applicant three or more business days prior to consummation or account opening. For purpose of this second type of waiver, revisions will only be considered to be clerical in nature if they have no impact on the estimated value, and have no impact on the calculation or methodology used to derive the estimate. In addition, under §1002.14(a)(1) the applicant still must receive the copy of the revision at or prior to consummation or account opening.*

7. ***Multiple versions of appraisals or valuations.*** *For purposes of §1002.14(a)(1), the reference to "all" appraisals and other written valuations does not refer to all versions of the same appraisal or other valuation. If a creditor has received multiple versions of an appraisal or other written valuation, the creditor is required to provide only a copy of the latest version received. If, however, a creditor already has provided a copy of one version of an appraisal or other written valuation to an applicant, and the creditor later receives a revision of that appraisal or other written valuation, then the creditor also must provide the applicant with a copy of the revision to comply with §1002.14(a)(1). If a creditor receives only one version of an appraisal or other valuation that is developed in connection with the applicant's application, then that version must be provided to the applicant to comply with §1002.14(a)(1). See also comment 14(a)(1)-4 above.*

Providing Appraisals and Valuations (Disclosure) – 12 CFR § 1002.14(a)(2)

Regulatory Discussion

Not later than the third business day after the creditor receives an application for credit (business or consumer purpose) that will be secured by a first lien on a "dwelling," the creditor must deliver the "right to receive a copy of appraisal" notice in writing.

In the event an application subsequently becomes subject to this notice requirement, the creditor shall deliver the notice no later than the third business day after it is determined that the loan will be secured by a first lien on a "dwelling."

There are two appraisal-related disclosure requirements for consumers. In the absence of regulatory action to harmonize the two provisions, creditors would be required to provide two appraisal-related disclosures to consumers for certain loans (i.e., a TILA and an ECOA disclosure for higher-risk mortgage loans secured by a first lien on a consumer's principal dwelling) and just one for certain others (i.e., an ECOA disclosure for first-lien, dwelling-secured loans that are not higher-risk mortgage loans, or a TILA disclosure for higher-risk mortgage loans secured by a subordinate lien).

As both disclosures were created by the same legislation to address overlapping subject matter, the CFPB revised the sample disclosure form C-9 for appraisals in Regulation B to include language to satisfy the new appraisal-related disclosure requirements of both ECOA and TILA. Thus, one disclosure satisfies both statutory requirements. The disclosure is as follows:

> *"We may order an appraisal to determine the property's value and charge you for this appraisal. We will promptly give you a copy of any appraisal, even if your loan does not close. You can pay for an additional appraisal for your own use at your own cost."*

Creditors may amend the language of form C-9 to reflect their individual policies and procedures. For example, a creditor may add a telephone number that applicants may call to provide information for appraisal mailing, or a notice of the cost the applicant will be required to pay the creditor for the appraisal or other valuation.

Regulatory Text

(a) Providing appraisals and other valuations

(2) **Disclosure.** For applications subject to paragraph (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.

Regulatory Commentary

14(a)(2) Disclosure.

1. ***Appraisal independence requirements not affected.*** *Nothing in the text of the disclosure required by §1002.14(a)(2) should be construed to affect, modify, limit, or supersede the operation of any legal, regulatory, or other requirements or standards relating to independence in the conduct of appraisers or the use of applicant-ordered appraisals by creditors.*

Providing Appraisals and Valuations (Reimbursement) – 12 CFR § 1002.14(a)(3)

Regulatory Discussion

A fee to provide the copy of the appraisal (or other written valuation) may not be assessed. The creditor, however, may be reimbursed for the actual cost of the appraisal (or other written valuation).

Creditors are not prohibited from charging a fee reasonably designed to reimburse costs incurred in connection with obtaining appraisal and other valuation services, but are prohibited from increasing the fee for the appraisal or other valuation to cover costs of providing documentation. The appraisal fees must be reasonable and customary in the market area where the property is located. Accordingly, the CFPB stated that it believed that the applicable TILA section is simply designed to prevent direct or indirect "upcharging" related to the provision of documents.

The CFPB included a clarifying comment that other laws may separately prohibit creditors from charging fees to reimburse the costs of appraisals, and these laws are not overridden by TILA. The Dodd-Frank Act requires creditors to obtain a second interior appraisal in connection with certain higher-risk mortgages, but prohibits creditors from charging applicants for the cost of the second appraisal.

The specific types of charges that are prohibited under the regulation include charges such as photocopying fees and postage for mailing a copy of appraisals or other written valuations. The regulation does not limit the recoverability of Appraisal Management Company (AMC) charges. Creditors may not increase the base cost of obtaining an appraisal or valuation to cover the cost of providing the copy to the applicant/borrower.

The final rule does not affect the ability of creditors to request up-front payment from applicants before appraisals or other written valuations are ordered (which would protect creditors even if the application is withdrawn, incomplete, or denied), to collect payment at consummation or account opening, or to undertake other efforts to collect the fee if the transaction is not consummated or the account is not opened.

The commentary provides additional information.

Regulatory Text

(a) Providing appraisals and other valuations

(3) **Reimbursement.** A creditor shall not charge an applicant for providing a copy of appraisals and other written valuations as required under this section, but may require applicants to pay a reasonable fee to reimburse the creditor for the cost of the appraisal or other written valuation unless otherwise provided by law.

Regulatory Commentary

14(a)(3) Reimbursement.

1. ***Photocopy, postage, or other costs.*** *Creditors may not charge for photocopy, postage, or other costs incurred in providing a copy of an appraisal or other written valuation in accordance with section 14(a)(1).*

2. ***Reasonable fee for reimbursement.*** *Section 1002.14(a)(3) does not prohibit a creditor from imposing a reasonable fee to reimburse the creditor's costs of the appraisal or other written valuation, so long as the fee is not increased to cover the costs of providing copies of such appraisals or other written valuations under §1002.14(a)(1). A creditor's cost may include an administration fee charged to the creditor by an appraisal management company as defined in 12 U.S.C. 3350(11). Section 1002.14(a)(3) does not, however, legally obligate the applicant to pay such fees. Further, creditors may not impose fees for reimbursement of the costs of an appraisal or other valuation where otherwise prohibited by law. For instance, a creditor may not charge a consumer a fee for the performance of a second appraisal if the second appraisal is required under 15 U.S.C. 1639h(b)(2) and 12 CFR 1026.35(c).*

Providing Appraisals and Valuations (Withdrawn, Denied, or Incomplete Applications) – 12 CFR § 1002.14(a)(4)

Regulatory Discussion

The requirement to provide a copy of the appraisal (or other written valuation) applies whether the credit is extended, denied, or withdrawn.

Creditors are required to provide copies of appraisals and other written valuations even in situations where an applicant provides only an incomplete application.

Regulatory Text

(a) Providing appraisals and other valuations

(4) **Withdrawn, denied, or incomplete applications.** The requirements set forth in paragraph (a)(1) of this section apply whether credit is extended or denied or if the application is incomplete or withdrawn.

Regulatory Commentary

None.

Providing Appraisals and Valuations (Copies in Electronic Form) – 12 CFR § 1002.14(a)(5)

Regulatory Discussion

The copy of the appraisal (or other written valuation) may be provided in electronic form as long as the creditor has received the applicant's consent and is in compliance with other applicable provisions of the E-Sign Act.

Regulatory Text

(a) Providing appraisals and other valuations

(5) **Copies in electronic form.** The copies required by §1002.14(a)(1) may be provided to the applicant in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 U.S.C. 7001 *et seq*.).

Regulatory Commentary

None.

Definitions (Consummation) – 12 CFR § 1002.14(b)(1)

Regulatory Discussion

The definition of "*consummation*" is a matter of state law that determines when a consumer becomes contractually obligated on a closed-end credit transaction.

Regulatory Text

(b) **Definitions.** For purposes of paragraph (a) of this section:

(1) **Consummation.** The term "consummation" means the time that a consumer becomes contractually obligated on a closed-end credit transaction.

Regulatory Commentary

14(b)(1) Consummation.

1. ***State law governs.*** *When a contractual obligation on the consumer's part is created is a matter to be determined under applicable law; §1002.14 does not make this determination. A contractual commitment agreement, for example, that under applicable law binds the consumer to the credit terms would be consummation. Consummation, however, does not occur merely because the consumer has made some financial investment in the transaction (for example, by paying a nonrefundable fee) unless, of course, applicable law holds otherwise.*

2. ***Credit vs. sale.*** *Consummation does not occur when the consumer becomes contractually committed to a sale transaction, unless the consumer also becomes legally obligated to accept a particular credit arrangement.*

Definitions (Dwelling) – 12 CFR § 1002.14(b)(2)

Regulatory Discussion

"*Dwelling*," as used in this section, means a residential structure that contains one to four units, whether or not it is attached to real property.

The motor vehicle exclusion is limited to this section and is not a pronouncement on whether boats, trailers, recreational vehicles, campers, or motor vehicles would otherwise fall within the definition of "dwelling" in other provisions of Regulation B.

The definition of "dwelling" in this section requires that the unit be a "residential structure", but does not require that it be "owner-occupied." As a result, the requirements of the final rule can apply to transactions involving one-to-four-unit residential structures that may be business or commercial in nature, including for investment purposes.

Regulatory Text

(b) **Definitions.** For purposes of paragraph (a) of this section:

(2) **Dwelling.** The term "dwelling" means a residential structure that contains one to four units whether or not that structure is attached to real property. The term includes, but is not limited to, an individual condominium or cooperative unit, and a mobile or other manufactured home.

Regulatory Commentary

14(b)(2) Dwelling.

1. "Motor vehicles" not covered. The requirements of §1002.14 do not apply to "motor vehicles" as defined by 12 U.S.C. 5519(f)(1).

Definitions (Valuation) – 12 CFR § 1002.14(b)(3)

Regulatory Discussion

"Valuation," as used in this section, means any estimate of value of a "dwelling" associated with an application for credit (business or consumer purpose) that will be secured by a "dwelling."

For clarity and consistency, the CFPB makes clear that an internal creditor valuation must be disclosed, regardless of whether a third-party appraisal report is prepared.

The commentary provides examples of "*valuations*" and guidance on "*attachments and exhibits*" and "*other documentation.*"

Regulatory Text

(b) **Definitions.** For purposes of paragraph (a) of this section:

(3) **Valuation.** The term “valuation” means any estimate of the value of a dwelling developed in connection with an application for credit.

Regulatory Commentary

14(b)(3) Valuation.

*1. **Valuations - examples.** Examples of valuations include but are not limited to:*

i. A report prepared by an appraiser (whether or not licensed or certified) including the appraiser's estimate of the property's value or opinion of value.

ii. A document prepared by the creditor's staff that assigns value to the property.

iii. A report approved by a government-sponsored enterprise for describing to the applicant the estimate of the property's value developed pursuant to the proprietary methodology or mechanism of the government-sponsored enterprise.

iv. A report generated by use of an automated valuation model to estimate the property's value.

v. A broker price opinion prepared by a real estate broker, agent, or sales person to estimate the property's value.

*2. **Attachments and exhibits.** The term “valuation” includes any attachments and exhibits that are an integrated part of the valuation.*

*3. **Other documentation.** Not all documents that discuss or restate a valuation of an applicant's property constitute a “valuation” for purposes of §1002.14(b)(3). Examples of documents that discuss the valuation of the applicant's property or may reflect its value but nonetheless are not “valuations” include but are not limited to:*

i. Internal documents that merely restate the estimated value of the dwelling contained in an appraisal or written valuation being provided to the applicant.

ii. Governmental agency statements of appraised value that are publically available.

iii. Publicly-available lists of valuations (such as published sales prices or mortgage amounts, tax assessments, and retail price ranges).

iv. Manufacturers' invoices for manufactured homes.

v. Reports reflecting property inspections that do not provide an estimate of the value of the property and are not used to develop an estimate of the value of the property.

vi. Appraisal reviews that do not include the appraiser's estimate of the property's value or opinion of value.

Section 10: Auditing Rules on Providing Appraisals and Other Valuations

Technique

This rule is for a loan that will be secured by a first lien on a dwelling, for business or consumer purpose.

Therefore, a careful analysis of what loans or loan types should be audited is required. This portion of the regulation is mostly procedural, so the audit must cover the procedures, and how they are applied within the bank.

Questions:

General

- Does the bank for each loan/application provide a copy of the 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?

- Does the bank permit applicants to waive the timing requirement and agree to receive any copy at or before consummation or account opening?

- Is any waiver obtained at least three business days prior to consummation or account opening?

- Does the bank provide these copies no later than 30 days after the creditor determines consummation will not occur or the account will not be opened?

- Does the bank take "3 days mailing time" into account if the appraisal is snail mailed?

- If there are multiple versions of appraisals or valuations, does the bank provide a copy of all appraisals to the applicant/customer?

- If the determination that the application/loan will be secured by a first lien on a "dwelling" after the application date, does the bank deliver the "right to receive a copy of appraisal" notice in writing at that time?

- Does the bank use the Regulation B approved language, or something substantially similar?

Providing Appraisals and Valuations (Reimbursement)

- Does the bank avoid charging a fee for the appraisal copy?

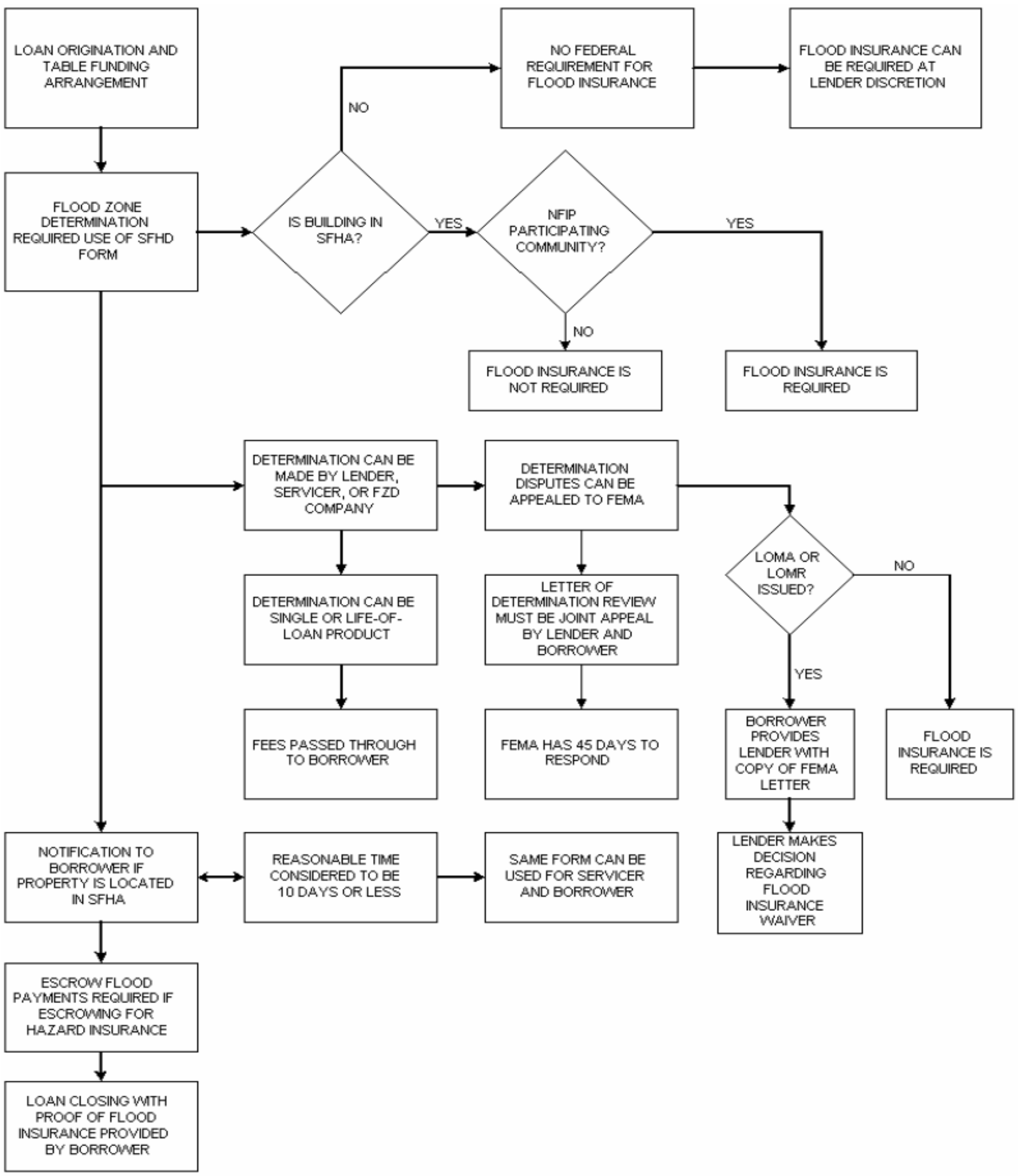
Providing Appraisals and Valuations (Copies in Electronic Form)

- Does the bank provide the copy of the appraisal in electronic form using the E-Sign Act?

Flood Knowledge

Section 1: Mandatory Purchase Flowchart

MANDATORY PURCHASE AT LOAN ORIGINATION
(Making, increasing, renewing, or extending a loan)



Section 2: National Flood Insurance Program Overview

General Insurance Requirements

Insurance Required at Loan Closing

A designated loan must have flood insurance as a condition of closing. If a borrower will not voluntarily obtain coverage, the lender must deny the loan. A lender cannot accept a borrower's assurance that he or she will obtain coverage in the future or grant the lender indemnity while he or she seeks coverage. Closing a designated loan without coverage in place constitutes a violation of the regulation.

Life-of-Loan Insurance Coverage

A key clarification of the 1994 Reform Act is that flood insurance must be obtained and maintained during the term of the loan. Regulated lending institutions and GSEs are responsible for providing notice of and requiring flood insurance coverage for the term of the loan on buildings located or to be located in any SFHA in participating communities. Flood insurance will be required even if the SFHA designation is first identified after settlement, but during the term of the loan. This requirement is designed to combat coverage lapses allowed to occur by individuals who believe they will not be flooded, and therefore discontinue payment of flood insurance premiums during the term of the loan.

Mandatory Purchase vs. Potential Flooding

While the mandatory purchase requirement applies only to buildings located in SFHAs of participating communities, NFIP flood insurance is available and highly encouraged in low-to-moderate flood risk areas of NFIP participating communities. This is especially significant because, historically, about 25 percent of the NFIP claims paid have actually been outside of SFHAs.

Lenders and property owners may wish to exercise additional caution and consider flood insurance in areas subject to flooding due to storm water, in areas where the NFIP has used approximate methods to map SFHAs, or in remote locations where no SFHAs have been designated by FEMA.

A requirement for flood insurance on secured property that is not subject to the mandatory purchase requirement is a matter of contract between the lender and borrower.

Some buildings in a participating community may be ineligible for Federal flood insurance because of statutory restrictions or NFIP underwriting rules. (For future reference, see pages 20-22 of the *2007 Guidelines* for a discussion of the lack of availability of Federal flood insurance in such instances.)

FDIC Regulatory Text Concerning Mandatory Purchase

§ 339.3 Requirement to purchase flood insurance where available.

(a) **In general.** An FDIC-supervised institution shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan. The amount of insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act. Flood insurance coverage under the Act is limited to the building or mobile home and any personal property that secures a loan and not the land itself.

(b) **Table funded loans.** An FDIC-supervised institution that acquires a loan from a mortgage broker or other entity through table funding shall be considered to be making a loan for the purpose of this part.

FDIC Regulatory Text Regarding Exemptions

§ 339.4 Exemptions.

The flood insurance requirement prescribed by § 339.3 does not apply with respect to:

(a) Any state-owned property covered under a policy of self-insurance satisfactory to the Administrator of FEMA, who publishes and periodically revises the list of states falling within this exemption;

(b) Property securing any loan with an original principal balance of $5,000 or less and a repayment term of one year or less; or

(c) Any structure that is a part of any residential property but is detached from the primary residential structure of such property and does not serve as a residence. For purposes of this paragraph (c):

(1) "a structure that is a part of a residential property" is a structure used primarily for personal, family, or household purposes, and not used primarily for agricultural, commercial, industrial, or other business purposes;

(2) a structure is "detached" from the primary residential structure if it is not joined by any structural connection to that structure; and

(3) "serve as a residence" shall be based upon the good faith determination of the FDIC-supervised institution that the structure is intended for use or actually used as a residence, which generally includes sleeping, bathroom, or kitchen facilities.

Lender Responsibilities

The statutory requirements apply when improved real property (that is, a building) or manufactured (mobile) home is taken as security for a loan. A lender's responsibilities include the following actions:

- Determine whether the building or manufactured (mobile) home offered as security for a loan is, or will be, located in an SFHA;
- Document the determination of flood hazard status, whether the building is in a low-to-moderate flood risk area or in an SFHA, on the current Standard Flood Hazard Determination Form (SFHDF);
- Provide notice to the borrower if collateral is, or will be, in an SFHA per the appropriate sample Notice of Special Flood Hazard and Availability of Federal Disaster Relief Assistance, the two versions of which are shown in Appendix 4 of the *2007 Guidelines*;
- Require that adequate flood insurance is obtained for buildings in SFHAs;
- Require the escrow of flood insurance premiums if escrow is required for other items, such as hazard insurance and taxes;
- During the term of the loan, ensure that flood insurance is maintained or obtained if the lender becomes aware that the building involved subsequently becomes part of an SFHA; and
- Force place flood insurance if the borrower allows the policy to lapse or if insurance is inadequate.

Section 3: Types of Flood Insurance Available and Coverage

Introduction

The following was taken from FEMA's Guide, and shows the types of insurances available through the National Flood Insurance Program.

Matching Standard Flood Insurance Policy Forms with Specific Risks

SFIP FORM

ELIGIBILITY

Dwelling Form

Issued to homeowner, residential renter, or owner of residential building containing 1 to 4 units.

In NFIP Regular Program community or Emergency Program community, provides building and/or contents coverage for:

- Single-family, non-condominium residence with incidental occupancy limited to less than 50% of the total floor area;
- 2–4 family, non-condominium building with incidental occupancy limited to less than 25% of the total floor area;
- Dwelling unit in residential condominium building;
- Residential townhouse/rowhouse;
- Personal contents in a non-residential building.

General Property Form

Issued to owner of residential building with 5 or more units.

In NFIP Regular Program community or Emergency Program community, provides building and/or contents coverage for these and similar "other residential" risks:

- Apartment building;
- Residential cooperative building;
- Dormitory;
- Assisted-living facility;
- Hotels, motels, tourist homes, and rooming houses that have more than 4 units where the normal guest occupancy is 6 months or more.

Issued to owner or lessee of non-residential business or other non-residential building or unit.

In NFIP Regular Program community or Emergency Program community, provides building coverage and/or contents coverage for these and similar non-residential risks:

- Hotel or motel with normal guest occupancy of less than 6 months;
- Licensed bed-and-breakfast inn;
- Retail shop, restaurant, or other business;
- Mercantile building;

- Grain bin, silo, or other farm building;
- Agricultural or industrial processing facility;
- Factory;
- Warehouse;
- Poolhouse, clubhouse, or other recreational building;
- House of worship;
- School;
- Nursing home;
- Non-residential condominium;
- Condominium building with less than 75% of its total floor area in residential use;
- Detached garage;
- Tool shed;
- Stock, inventory, or other commercial contents.

Residential Condominium Building Association Policy (RCBAP)

Issued to residential condominium association on behalf of association and unit owners.

In NFIP Regular Program community only, provides building coverage and, if desired, coverage of commonly owned contents for residential condominium building with 75% or more of its total floor area in residential use.

Insurance Products

The following products are available under the SFIP:

1. **Preferred Risk Policy (PRP)**

   The PRP is available in minimal-risk flood zones (C Zones and unshaded X Zones) and moderate-risk flood zones (B Zones and shaded X Zones). Information about coverage options and eligibility requirements for the PRP is provided in the PRP section of this manual.

2. **Newly-Mapped-Rated Policy**

   The Newly Mapped procedure applies to properties previously in Zones B, C, X, or D that have been newly mapped into a Special Flood Hazard Area (SFHA). This procedure also applies to policies previously issued under the Preferred Risk Policy Eligibility Extension that are renewing on or after April 1, 2015.

3. **Mortgage Portfolio Protection Program (MPPP)**

   The Mortgage Portfolio Protection Program (MPPP) offers a force-placed policy available only through a Write Your Own (WYO) Company. Additional information is provided in the MPPP section of this manual.

4. **Scheduled Building Policy**

   The Scheduled Building Policy is available to cover 2 to 10 buildings. The policy requires a specific amount of insurance to be designated for each building. To qualify, all buildings must have the same ownership and the same location. The properties on which the buildings are located must be contiguous.

5. **Group Flood Insurance**

   Group Flood Insurance is issued under the NFIP Direct Program in response to a Presidential disaster declaration. Disaster assistance applicants, in exchange for a modest premium, receive a minimum amount of building and/or contents coverage for a 3-year policy period. The Group Flood Insurance Policy cannot be canceled. However, an applicant may purchase a regular SFIP through the NFIP. When this is done, the group flood certificate for the property owner is void, and premium will not be refunded.

Section 4: Buildings Eligible for Flood Coverage

Introduction

This entire section of this manual is a direct quote from the FEMA Guide. We have formatted the information, but have not made any further edits. The reader should be aware that this section was designated as "III." In the manual, and "III." is used below as a reference number.

Building Property Eligibility (FEMA Guide)

A. Eligible Buildings

Insurance may be written only on a structure with 2 or more outside rigid walls and a fully secured roof that is affixed to a permanent site. Buildings must resist flotation, collapse, and lateral movement. At least 51% of the Actual Cash Value (ACV) of buildings, including machinery and equipment, which are a part of the buildings, must be above ground level, unless the lowest level is at or above the Base Flood Elevation (BFE) and is below ground by reason of earth having been used as insulation material in conjunction with energy-efficient building techniques.

1. **Appurtenant Structures**

The only appurtenant structure covered by the SFIP is a detached garage at the described location, which is covered under the Dwelling Form. Coverage is limited to no more than 10% of the limit of liability on the dwelling. Use of this insurance is at the policyholder's option but reduces the building limit of liability.

Appurtenant structure coverage does not apply to any detached garage used or held for use for residential (dwelling), business, or farming purposes.

2. **Manufactured (Mobile) Homes/Travel Trailers**

Eligible buildings also include:

A manufactured home (a "manufactured home," also known as a mobile home, is a structure built on a permanent chassis, transported to its site in 1 or more sections, and affixed to a permanent foundation); and

A travel trailer without wheels, built on a chassis and affixed to a permanent foundation, that is regulated under the community's floodplain management and building ordinances or laws.

NOTE: All references in this manual to manufactured (mobile) homes include travel trailers without wheels.

a. **Manufactured (Mobile) Homes – New Policies Effective on or after October 1, 1982**

To be insurable under the NFIP, a mobile home:

Must be affixed to a permanent foundation. A permanent foundation for a manufactured (mobile) home may be poured masonry slab or foundation walls, or may be piers or block supports, either of which support the mobile home so that no weight is supported by the wheels and axles of the mobile home.

Must be anchored if located in a Special Flood Hazard Area (SFHA). For flood insurance coverage, all new policies and subsequent renewals of those policies must be based upon the specific anchoring requirements identified below:

A manufactured (mobile) home located within an SFHA must be anchored to a permanent foundation to resist flotation, collapse, or lateral movement by providing over-the-top or frame ties to ground anchors; or in accordance with manufacturer's specifications; or in compliance with the community's floodplain management requirements.

b. **Manufactured (Mobile) Homes – Continuously Insured Since September 30, 1982**

All manufactured (mobile) homes on a foundation continuously insured since September 30, 1982, can be renewed under the previously existing requirements if affixed to a permanent foundation.

Manufactured (mobile) homes in compliance with the foundation and anchoring requirements at the time of placement may continue to be renewed under these requirements even though the requirements are more stringent at a later date.

To be adequately anchored, the manufactured (mobile) home is attached to the foundation support system, which in turn is established (stabilized) into the ground, sufficiently to resist flotation, collapse, and lateral movement caused by flood forces, including wind forces in coastal areas.

3. **Silos and Grain Storage Buildings**

4. **Cisterns**

5. **Buildings Entirely Over Water – Constructed or Substantially Improved before October 1, 1982**

Follow Submit-for-Rate procedures in the Rating section if the building is located entirely in, on, or over water or seaward of mean high tide. If the building is Pre-FIRM, the Submit-for-Rate procedure may be used to determine optional full-risk rates; otherwise, Pre-FIRM buildings remain eligible for Pre-FIRM subsidized rates.

If the building was constructed or substantially improved on or after October 1, 1982, the building is ineligible for coverage.

Exception: If a building was originally constructed on land or partially over water, and later becomes entirely over water because of erosion, it is eligible for coverage only if the building has had continuous coverage:

- from the period beginning at least 1 year prior to the building being located entirely over water, regardless of any changes in the ownership of the building; or
- from the date of construction if less than 1 year.

Acceptable documentation of a building's continued eligibility for coverage must include the following:

- A letter from the community official stating that the building originally was constructed on land or only partially over water; and
- Photographs of the building over land, if available; and
- The approximate date when the building became located entirely over water; and
- Proof of continuous flood insurance coverage from the period beginning 1 year prior to the building being located entirely over water, or from the date of construction if less than 1 year.

6. **Buildings Partially Over Water**

Follow Submit-for-Rate procedures in the Rating section if the building is partially over water. If the building is Pre-FIRM, the Submit-for-Rate procedure may be used to determine optional full-risk rates; otherwise, Pre-FIRM buildings remain eligible for Pre-FIRM subsidized rates.

7. **Boathouses Located Partially Over Water**

The non-boathouse parts of a building into which boats are floated are eligible for coverage if the building is partly over land and also used for residential, commercial, or municipal purposes and is eligible for flood coverage. The area above the boathouse used for purposes unrelated to the boathouse use (e.g., residential occupancy) is insurable from the floor joists to the roof, including walls. A common wall between the boathouse area and the other part of the building is insurable. The following items are not covered:

a. The ceiling and roof over the boathouse portions of the building into which boats are floated;

b. Floors, walkways, decking, etc., within the boathouse area, or outside the area, but pertaining to boathouse use;

c. Exterior walls and doors of the boathouse area not common to the rest of the building;

d. Interior walls and coverings within the boathouse area; and

e. Contents located within the boathouse area, including furnishings and equipment, relating to the operation and storage of boats and other boathouse uses.

The Flood Insurance Application form with photographs, but without premium, must be submitted to the NFIP for premium determination. No coverage becomes effective until the NFIP approves the insurance application, determines the rate, and receives the premium. However, buildings constructed prior to October 1, 1982, may continue to be rated using the published rate.

8. **Buildings in the Course of Construction**

   NFIP rules allow for the issuance of an SFIP to cover a building in the course of construction before it is walled and roofed. These rules provide lenders with an option to require flood insurance coverage at the time that the development loan is made to comply with the mandatory purchase requirement outlined in the Flood Disaster Protection Act of 1973, as amended. The policy is issued and rated based on the construction designs and intended use of the building.

   Buildings in the course of construction that have yet to be walled and roofed are eligible for coverage except when construction has been halted for more than 90 days and/or if the lowest floor used for rating purposes is below the BFE. Materials or supplies intended for use in such construction, alteration, or repair are not insurable unless they are contained within an enclosed building on the premises or adjacent to the premises.

   To determine the eligibility of a residential condominium building under construction, see the Condominiums section of this manual.

9. **Severe Repetitive Loss Properties**

   These must be processed by the NFIP Special Direct Facility. Refer to the Severe Repetitive Loss section of this manual for information.

B. Single Building

To qualify as a single-building structure and be subject to the single-building limits of coverage, a building must be:

1. Separated from other buildings by intervening clear space; or
2. Separated into divisions by solid, vertical, load-bearing walls; each division may be insured as a separate building.
   a. These walls must divide the building from its lowest level to its highest ceiling and have no openings.
   b. If there is access through the division wall by a doorway or other opening, the structure must be insured as 1 building unless it meets all of the following criteria:
      - It is a separately titled building contiguous to the ground; and
      - It has a separate legal description; and
      - It is regarded as a separate property for other real estate purposes, meaning that it has most of its own utilities and may be deeded, conveyed, and taxed separately.

Additions and Extensions

The NFIP insures additions and extensions attached to and in contact with the building by means of a rigid exterior wall, a solid load-bearing interior wall, a stairway, an elevated walkway, or a roof. At the insured's option, additions and extensions connected by any of these methods may be separately insured. Additions and extensions attached to and in contact with the building by means of a common interior wall that is not a solid load-bearing wall are always considered part of the building and cannot be separately insured.

When insuring additions and extensions separately, an application must be submitted with required rating information specific to the addition or extension. The application must clearly describe the addition or extension being insured. If contents coverage is desired within the addition or extension, it must be requested on the application. When insuring a building with multiple attached additions and extensions, the applicant must choose between purchasing one policy or separate policies for the building and each addition and extension.

C. Walls

1. Breakaway Walls

For an enclosure's wall to qualify as breakaway, it must meet all of the following criteria:

a. Above ground level; and

b. Below the elevated floor of an elevated structure; and

c. Non-structurally supporting (non-load-bearing walls); and

d. Designed to fail under certain wave force conditions; and

e. Designed so that, as a result of failure, it causes no damage to the elevated portions of the elevated building and/or its supporting foundation system.

2. Shear Walls

Shear walls are used for structural support, but are not structurally joined or enclosed at the ends (except by breakaway walls). Shear walls used as the method of elevating a building are normally parallel (or nearly parallel) to the expected flow of floodwaters.

3. Solid (Perimeter) Foundation Walls

Solid (perimeter) foundation walls are used as a means of elevating the building in A Zones and must contain proper openings to allow for the unimpeded flow of floodwaters more than 1 foot deep.

Solid (perimeter) foundation walls are not an acceptable means of elevating buildings in V/VE Zones.

D. Determination of Building Occupancy

The following terms should be used to determine the appropriate occupancy classification:

1. Single-Family Dwelling

This is either:

a. A residential single-family building in which the total floor area devoted to non-residential uses is less than 50% of the building's total floor area, or

b. A single-family residential unit within a 2–4 family building, other-residential building, business, or non-residential building, in which commercial uses within the unit are limited to less than 50% of the unit's total floor area.

This includes a residential townhouse/rowhouse, which is a multi-floor unit divided from similar units by solid, vertical, load-bearing walls, having no openings in the walls between units and with no horizontal divisions between any of the units.

NOTE: Commercial uses within the unit are offices, private schools, studios, or small service operations within a residential building.

2. **2–4 Family Building**

This is a residential building, including an apartment building, containing 2–4 residential spaces and in which commercial uses are limited to less than 25% of the building's total floor area. This category includes apartment buildings and condominium buildings. This excludes hotels and motels with normal room rentals for less than 6 months.

3. **Other Residential Building**

This is a residential building that is designed for use as a residential space for 5 or more families or a mixed-use building in which the total floor area devoted to non-residential uses is less than 25% of the total floor area within the building. This category includes condominium and apartment buildings as well as hotels, motels, tourist homes, and rooming houses where the normal occupancy of a guest is 6 months or more. Additional examples of other residential buildings include dormitories and assisted-living facilities.

4. **Non-Residential Business**

A building in which the named insured is a commercial enterprise primarily carried out to generate income and the coverage is for:

a. A building designed as a non-habitational building;

b. A mixed-use building in which the total floor area devoted to residential uses is

i. 50% or less of the total floor area within the building if the residential building is a single family property; or

ii. 75% or less of the total floor area within the building for all other residential properties; or

c. A building designed for use as office or retail space, wholesale space, hospitality space, or for similar uses.

5. **Other Non-Residential**

This is a subcategory of non-residential buildings; a non-habitational building that does not qualify as a business building or mixed-use building that does not qualify as a residential building. This category includes, but is not limited to, churches, schools, farm buildings (including grain bins and silos), garages, poolhouses, clubhouses and recreational buildings. A small business cannot use this category.

E. Primary Residence Determination

FEMA defines a primary residence as a single family building, condominium unit, apartment unit, or unit within a cooperative building that will be lived in by the policyholder or the policyholder's spouse for more than 50% of the 365 calendar days following the current policy effective date or 50% or less of the 365 calendar days following the current policy effective date if the policyholder has only one residence and does not lease that residence to another party or use it as rental or income property at any time during the policy term.

A policyholder and the policyholder's spouse may not collectively have more than one primary residence.

Policyholders with primary residences could include the following, as long as they meet the conditions above:

1. Active-duty military personnel who are deployed for 50% or more of the policy year in compliance with military orders;
2. Policyholders displaced from a primary residence and living in a temporary residence due to a federally declared disaster or a loss event on the primary residence claimed on any line of insurance for 50% or more of the policy year; or
3. Policyholders who are absent from a primary residence for reasons such as routine business travel, hospitalizations, and/or vacation for 50% or more of the policy year.

Acceptable documentation for a primary residence status requires one of the following: Homestead Tax Credit Form for Primary Residence, driver's license, automobile registration, proof of insurance for a vehicle, voter's registration, or documents showing where children attend school.

If documentation of a primary residence is not available, the insurer must obtain a signed and dated statement from the applicant with the text below:

[Omitted, as this is an insurance agent issue.]

Flood Requirements and Audit

Section 1: Special Flood Hazard Determination Form

Introduction

The 1994 reforms to flood legislation required the development of a standard form for determining, in the case of a loan secured by improved real estate or a mobile home, whether a building or mobile home is located in an area identified as a special flood hazard and in an area in which national flood insurance is available. The flood regulations require that covered lenders shall use the Standard Flood Hazard Determination (SFHD) form as developed by the Director of FEMA when determining whether a building or mobile home offered as collateral security for a loan is or will be located in a Special Flood Hazard Area (SFHA) in which flood insurance is available under the Act.

Should collateral pledged as security on a loan be located in a SFHA, the lender is also required to provide an appropriate notice to the borrower indicating whether flood insurance is available.

This portion of the manual explores the SFHD form and the flood notice, as well as any additional notices that may be required in connection with a covered loan.

FDIC Regulatory Text Regarding the SFHDF

§ 339.6 Required use of standard flood hazard determination form.

(a) **Use of form**. An FDIC-supervised institution shall use the standard flood hazard determination form developed by the Administrator of FEMA when determining whether the building or mobile home offered as collateral security for a loan is or will be located in a special flood hazard area in which flood insurance is available under the Act. The standard flood hazard determination form may be used in a printed, computerized, or electronic manner. An FDIC-supervised institution may obtain the standard flood hazard determination form from FEMA's website at www.fema.gov.

(b) **Retention of form.** An FDIC-supervised institution shall retain a copy of the completed standard flood hazard determination form, in either hard copy or electronic form, for the period of time the FDIC-supervised institution owns the loan.

The Importance of a Building's Location

The statutory requirement to purchase flood insurance applies only when a loan is extended on improved real property (i.e., a building or manufactured [mobile] home) that is located or will be located in an SFHA in a participating community.

Even though a portion of real property on which a building is located may lie within an SFHA, the purchase and notice requirements do not apply unless the building itself, or some part of the building, is in the SFHA. However, even if that part of the building within the SFHA is not subject to coverage (e.g., a deck), the entire building is considered to be in the SFHA.

Lenders, on their own initiative, may require the purchase of flood insurance even if a building is located outside an SFHA. A decision to require coverage under such circumstances is not compelled by the statute, but is founded on the contractual relationship between the parties. Lenders have the prerogative to require flood insurance to protect their investments, provided that they have reserved that option in their mortgage loan document.

The law sets the ultimate responsibility to place flood insurance on the applicable lender, yet allows for limited reliance on third parties to the extent that the information they provide is guaranteed. The lender, servicer, or a third-party vendor may conduct the determination of a building's location.

Under any alternative, the lender, using such evidence as is reasonable, must take the responsibility for making determinations and redeterminations. A financial institution cannot rely on the statements of a borrower that the structure in question is either inside or outside an SFHA.

Lenders may reasonably seek assistance from third parties that have demonstrated their knowledge concerning flood map information. For regulatory purposes, reasonable reliance upon such services in the making of a lender's determination is regarded as acceptable only to the extent that "such person guarantees the accuracy of the information."

In many instances, community officials, insurance company personnel, insurance agents, real estate agents, surveyors, or appraisers may be helpful and knowledgeable resources. However, to the extent that such parties cannot or will not grant guarantees, reliance upon the information they provide cannot be used for exculpatory purposes if the lender is confronted with a regulatory violation or a civil claim for damages.

Regardless of how the determination is reached, the nondelegable obligation of the determination remains the responsibility of the lender.

A lender may rely on a previous determination, not more than seven years old, when increasing, extending, renewing, or purchasing a loan, but only when the previous determination was recorded on an SFHDF. This rule does not apply when a new loan is made, or if a map revision causes a building to be located within an SFHA, or if a map change occurs after the date of the previous determination.

Standard Flood Hazard Determination Form

The Standard Flood Hazard Determination Form (SFHDF) is used to comply with Section 303 (a) of Title V of the National Flood Insurance Reform Act of 1994 (NFIRA). The SFHDF is used by federally regulated lending institutions when making, increasing, extending, renewing or purchasing a loan for the purpose of determining whether flood insurance is required and available. The form may also be used by insurance agents, property owner, realtors and community officials for flood insurance related activities and flood zone documentation.

The SFHD form contains sections which detail information relating to the lender, collateral, flood map information, flood insurance availability, and information about the preparer of the SFHD.

Using Third Parties to Prepare SFHD Forms

The Act sets the ultimate responsibility to place flood insurance on the lender, yet allows for limited reliance on third parties to the extent that the information they provide is guaranteed. Therefore, the lender, servicer, or a third-party vendor may conduct the determination of a building's location. Regardless of the alternative chosen, the lender must take the responsibility for making determinations and redeterminations. Under no circumstances should a financial institution rely on the statements of a borrower that the structure in question is either inside or outside an SFHA. The Act provides appropriate channels to resolve disputes by a borrower when the location of collateral in or out of a SFHA is in question.

Lenders may reasonably seek assistance from third parties that have demonstrated their knowledge concerning flood map information. For regulatory purposes, reasonable reliance upon such services in the making of a lender's determination is regarded as acceptable only to the extent that "such person guarantees the accuracy of the information."

Some third-party flood zone determination companies also provide a form of life-of-loan service that monitors the flood hazard status of the secured structure for the term of the loan. Third-party life-of-loan service is designed to discover a change in flood hazard status, thereby minimizing the administrative burden for the lender or servicer. The law does not require a lender to subscribe to a tracking service that provides life-of-loan monitoring.

Given the unique skill base required to accurately read and interpret flood maps, many lenders today rely on the use of third-party service providers to prepare SFHD forms. In many lenders' shops, this necessary skill base extends beyond the resources available within the bank. These third parties can offer these skills at a reasonable cost and most often back up their preparations with a compliance guarantee.

In addition, for the lender's and borrower's protection, the third parties typically offer a "life-of-loan" service to be purchased at the time of the initial preparation of the SFHD form. This life-of-loan service, if purchased by the lender, will serve to inform the lender of any changes to the flood map affecting the property pledged security. This service provides a peace of mind to the lender and borrower to receive a notification if the collateral is subsequently affected by either becoming considered as located in a SFHA or a remapping that removes the collateral from a SFHA, thereby eliminating the need for the borrower to maintain flood insurance. This life-of-loan service is not mandated by the Act.

Elements of the SFHD Form

The following pages contain the current SFHD form. The instructions are included on the following pages.

DEPARTMENT OF HOMELAND SECURITY

Federal Emergency Management Agency

STANDARD FLOOD HAZARD DETERMINATION FORM (SFHDF)

OMB Control No. 1660-0040
Expires: 10/31/18

SECTION I - LOAN INFORMATION

1. LENDER/SERVICER NAME AND ADDRESS	2. COLLATERAL DESCRIPTION (Building/Mobile Home/Property) (See instructions for more information.)	
3. LENDER/SERVICER ID #	4. LOAN IDENTIFIER	5. AMOUNT OF FLOOD INSURANCE REQUIRED

SECTION II

A. NATIONAL FLOOD INSURANCE PROGRAM (NFIP) COMMUNITY JURISDICTION

1. NFIP Community Name	2. County(ies)	3. State	4. NFIP Community Number

B. NATIONAL FLOOD INSURANCE PROGRAM (NFIP) DATA AFFECTING BUILDING/MOBILE HOME

1. NFIP Map Number or Community-Panel Number (Community name, if not the same as "A")	2. NFIP Map Panel Effective / Revised Date	3. Is there a Letter of Map Change (LOMC)? ◯ NO ◯ YES (If yes, and LOMC date/no. is available, enter date and case no. below). Date Case No.
4. Flood Zone	5. No NFIP Map	

C. FEDERAL FLOOD INSURANCE AVAILABILITY (Check all that apply.)

1. ☐ Federal Flood Insurance is available (community participates in the NFIP). ☐ Regular Program ☐ Emergency Program of NFIP
2. ☐ Federal Flood Insurance is not available (community does not participate in the NFIP).
3. ☐ Building/Mobile Home is in a Coastal Barrier Resources Area (CBRA) or Otherwise Protected Area (OPA). Federal Flood Insurance may not be available.

CBRA/OPA Designation Date: ____________________

D. DETERMINATION

IS BUILDING/MOBILE HOME IN SPECIAL FLOOD HAZARD AREA (ZONES CONTAINING THE LETTERS "A" OR "V")? ☐ YES ☐ NO

If yes, flood insurance is required by the Flood Disaster Protection Act of 1973.
If no, flood insurance is not required by the Flood Disaster Protection Act of 1973. Please note, the risk of flooding in this area is only reduced, not removed.

This determination is based on examining the NFIP map, any Federal Emergency Management Agency revisions to it, and any other information needed to locate the building /mobile home on the NFIP map.

E. COMMENTS (Optional)

F. PREPARER'S INFORMATION

NAME, ADDRESS, TELEPHONE NUMBER (If other than Lender)	DATE OF DETERMINATION

FEMA Form 086-0-32 (06/16)

SFHDF - Form Page 1 of 1

Federal Emergency Management Agency

Standard Flood Hazard Determination Form (SFHDF)

Instructions

Section 1

1. ***Lender/Servicer Name and Address:*** Enter lender name and address.
2. ***Collateral Description:*** Preparer should coordinate with user to ensure the collateral is sufficiently identified. Suggested forms of collateral identification include, but are not limited to, property address, parcel or lot number and longitude/latitude. If needed, additional information may be attached to this form.
3. ***Lender/Servicer ID No:*** Optional. Preparer should coordinate with user to ensure the lender is sufficiently identified on the form. The lender name and address (Box 1. above) may be sufficient.
4. ***Loan Identifier:*** Optional. May be used by lenders to conform with their individual Method of Identifying Loans.
5. ***Amount of Flood Insurance Required:*** Optional. The minimum federal requirement for this amount is the lesser of: the outstanding principal loan balance; the value of the improved property, mobile home and/or personal property used to secure the loan; or the maximum statutory limit of flood insurance coverage. A lender retains the prerogative to require flood insurance in excess of the minimum federal requirements not by the direction of FEMA. National Flood Insurance Program (NFIP) policies do not provide coverage in excess of the insured value of the building/mobile home/personal property.

Section 2

A. National Flood Insurance Program (NFIP) Community Jurisdiction

1. ***NFIP Community Name***. Enter the complete name of the community (as indicated on the NFIP map) in which the building or mobile home is located. Under the NFIP, a community is the political unit that has authority to adopt and enforce floodplain management regulations for the areas within its jurisdiction. A community may be any State or area or political subdivision thereof, or any Indian tribe or authorized tribal organization, or Alaska Native village or authorized native organization. (Examples: Brewer, City of; Washington, Borough of; Worchester, Township of; Baldwin County; Jefferson Parish) For a building or mobile home that may have been annexed by one community but is shown on another community's NFIP map, enter the Community Name for the community with land-use jurisdiction over the building or mobile home.
2. ***County(ies).*** Enter the name of the county or counties in which the community is located. For unincorporated areas of a county, enter "unincorporated areas." For independent cities, enter "independent city."
3. ***State.*** Enter the two-digit state abbreviation. (Examples: VA, TX, CA)
4. ***NFIP Community Number.*** Enter the 6-digit NFIP community number. This number can be determined by consulting the NFIP Community Status Book or can be found on the NFIP map; copies of either can be obtained from FEMA's Website http://msc/fema.gov

or by calling 1-800-358-9616. If no NFIP Community Number exists for the community, enter "none."

NFIP Data Affecting Building/Mobile Home

The information in this section (excluding the LOMA/LOMR information) is obtained by reviewing the NFIP map on which the building/mobile home is located. The current NFIP map may be obtained from FEMA by calling 1-800-358-9616. Scanned copies of the NFIP maps can be viewed on FEMA's website at http://msc.fema.gov. Note that even when an NFIP map panel is not printed, it may be reflected on a community's NFIP map index with its proper number, date, and flood zone indicated; enter these data accordingly.

1. NFIP Map Number or Community-Panel Number. Enter the 11-digit number shown on the NFIP map that covers the building or mobile home. (Examples: 480214 0022C; 58103C0075F). Some older maps will have a 9-digit number (Example: 12345601A). Note that the first six digits will not match the NFIP Community Number when the sixth digit is a "C" or when one community has annexed land from another but the NFIP map has not yet been updated to reflect this annexation. When the sixth digit is a "C", the NFIP map is in countywide format and shows the flood hazards for the geographic areas of the county on one map, including flood hazards for incorporated communities and for any unincorporated county contained within the county's geographic limits. Such countywide maps will list an NFIP Map Number. For maps not in such countywide format, the NFIP will list a Community-Panel Number on each panel. If no NFIP map is in effect for the location of the building or mobile home, enter "none."
2. NFIP Map Panel Effective/Revised Date. Enter the map effective date or the map revised date shown on the NFIP map. (Example: 6/15/93) This will be the latest of all dates shown on the map.
3. Is there a Letter of Map Change (LOMC)? This field can remain blank if no Letter of Map Change (LOMC) (these include the Letter of Map Amendment (LOMA), Letter of Map Revision (LOMR) or similar FEMA Map Letter(s)) applies to the subject property. If there is a LOMC, list the date and number. Information on the LOMC is available from the following sources:

    * The community's official copy of its NFIP map(s) should have a copy of all subsequently-issued FEMA Letters attached.

    * For a LOMC issued on or after October 1, 1994. Information is available on FEMA's website at http://www.fema.gov/national-flood-insurance-program-flood-hazard-mapping/compendium-flood-map-changes

    * The FEMA Map Service Center website is https://msc.fema.gov/portal

4. Flood Zone. Enter the flood zone(s) in which the building or mobile home is located. (Examples: A, AE, A4, AR, AR/A, AR/AE, AR/AO, V, VE, V12, AH, AO, B, C, X, D). If any part of the building or mobile home is within the Special Flood Hazard Area (SFHA), the entire building or mobile home is considered to be in the SFHA. All flood zones beginning with the letter "A" or "V" are considered to be in the SFHA. Each flood zone is defined in the legend of the NFIP map on which it appears. If there is no NFIP map for the subject area, enter "none."
5. No NFIP Map. If no NFIP map covers the area where the building or mobile home is located, check this box.

Federal Flood Insurance Availability

This is a of community eligibility; it does not address individual building related eligibility, that is reviewed in the insurance process.

Check all boxes that apply; Note that boxes 1 (Federal Flood Insurance is available ...) and 2 (Federal Flood Insurance is not available ...) are mutually exclusive. In most instances, Federal flood insurance is available to all residents with eligible property in a community that participates in the NFIP. Community participation status can be determined by consulting the NFIP Community Status Book, which is available from FEMA and at http://www.fema.gov/fema/csb.shtm. The NFIP Community Status Book will indicate whether or not the community is participating in the NFIP and whether participation is in the Emergency or Regular Program. If the community participates in the NFIP, check either Regular Program or Emergency Program. To obtain Federal flood insurance, a copy of this completed form may be provided to an insurance agent.

Federal flood insurance is prohibited in areas designated by the Coastal Barrier Resources Act to be in a Coastal Barrier Resources Area (CBRA) and Otherwise Protected Areas (OPA) for buildings or mobile homes built or substantially improved after the date of the CBRA or OPA designation. Information about the Coastal Barrier Resources System (CBRS) may be obtained by visiting the U.S. Fish and Wildlife Service's website at http://www.fws.gov/CBRA/index.html

Determination

If any portion of the building/mobile home is in an identified Special Flood Hazard Area (SFHA), check yes (flood insurance is required). If no portion of the building/mobile home is in an identified SFHA, check no. If no NFIP map exists for the community, check no. If no NFIP map exists, Section B5 should also be checked.

Comments

Optional Comment. Preparer may add additional comments/pages/data as needed.

Preparer's Information

If other than the lender, enter the name, address, and telephone number of the company or organization performing the flood hazard determination. An individual's name may be included, but is not required.

Date of Determination. Enter date on which flood zone determination was completed.

Multiple Buildings. For guidance regarding multiple buildings, please contact your regulator, servicer, lender or other entity as applicable.

Guarantees Regarding Information. Determinations on this form made by persons other than the lender are acceptable only to the extent that the accuracy of the information is guaranteed.

Form Availability. The form is available at http://www.fema.gov/plan/prevent/fhm/frm_form.shtm). Copies of this form are available from the FEMA fax-on-demand line by calling (202) 646-FEMA and requesting form #23103. Guidance on using the form in a printed, computerized, or electronic format is contained in form #23110. This information is also available on FEMA's website. See the resource record, for usability purposes. The URL is http://www.fema.gov/media-library/assets/documents/225?id=1394

Purpose of Form. In accordance with P.L. 103-325, Sec. 1365, (b) (1), this form has been designated to facilitate compliance with the flood insurance purchase requirements of the National Flood Insurance Reform Act of 1994.

For Lending Related Guidance Regarding This Form. Implementation of the mandatory flood insurance purchase requirements of the Flood Disaster Protection Act of 1973 and the National Flood Insurance Reform Act of 94, as amended, is the responsibility of the various Federal agencies that regulate lenders. Please contact your regulator or lender to determine their requirements.

Reliance on the SFHDF

The lender must take the responsibility for making flood zone determinations. The 1994 Reform Act states that the lender may provide for the acquisition or determination of flood hazard information to be made by a person other than the lender only to the extent that such person guarantees the accuracy of the information.

A previous determination may not be reused when making a new loan. If the loan is not new, (i.e., if the transaction pertains to increasing, extending, renewing, or purchasing an existing loan) the determination can be reused if:

- It is less than 7 years old; and
- No new or revised FIRM or FHBM has been issued in the interim; and
- It was initially recorded on the SFHDF.

If a borrower obtains a home equity or second mortgage from its first mortgagee that is secured by a secondary lien position, and provides evidence that adequate flood insurance coverage is in place for all loans, the lender can rely upon the original SFHDF if no remapping has occurred.

Once a new map has been issued, a lender must use that map as a guide, and a new determination is required.

A separate SFHDF is required for buildings on adjacent properties. However, if a single property contains multiple buildings, a listing of buildings on the parcel can be attached to the SFHDF.

Only one building may be insured under one NFIP policy. Each building securing a loan must be covered by a separate policy.

The form need not be kept in the loan file, but a lender is expected to be able to retrieve the record within a reasonable time period upon being requested by its federal supervisory agency. Lenders are neither required to provide, nor prohibited from providing, the WYO insurer, insurance agent, or the borrower with a copy of the form.

Lenders and servicers cannot accept self-certification or assurance from the mortgagor-borrower that the building is not in an SFHA. If the lender wishes to change its original determination of the building's location based on information submitted by the mortgagor, the lender/servicer must conclude that its original determination was in error and make any change on the basis of its review of that new information.

The ultimate responsibility for making such determinations about a building's flood zone location rests with the mortgagee, not the mortgagor. Contested determinations are subject to the FEMA review process.

FDIC Regulatory Text Concerning Determination Fees

§ 339.8 Determination fees.

(a) **General.** Notwithstanding any Federal or State law other than the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4001--4129), any FDIC-supervised institution, or a servicer acting on its behalf, may charge a reasonable fee for determining whether the building or mobile home securing the loan is located or will be located in a special flood hazard area. A determination fee may also include, but is not limited to, a fee for life-of-loan monitoring.

(b) **Borrower fee.** The determination fee authorized by paragraph (a) of this section may be charged to the borrower if the determination:

(1) Is made in connection with a making, increasing, extending, or renewing of the loan that is initiated by the borrower;

(2) Reflects the Administrator of FEMA's revision or updating of floodplain areas or flood-risk zones;

(3) Reflects the Administrator of FEMA's publication of a notice or compendium that:

(i) Affects the area in which the building or mobile home securing the loan is located; or

(ii) By determination of the Administrator of FEMA, may reasonably require a determination whether the building or mobile home securing the loan is located in a special flood hazard area; or

(4) Results in the purchase of flood insurance coverage by the lender or its servicer on behalf of the borrower under § 339.7.

(c) **Purchaser or transferee fee.** The determination fee authorized by paragraph (a) of this section may be charged to the purchaser or transferee of a loan in the case of the sale or transfer of the loan.

Section 2: Flood Determination Form Audit

Procedure

The requirements of each field are included below. For each, the answer is Yes / No / N/A.

The Audit

Section 1

Lender/Servicer Name and Address: ________________

Collateral Description: ________________

Lender/Servicer ID No: Optional. _______________

Loan Identifier: Optional. _______________

Amount of Flood Insurance Required: Optional. _______________

Section 2

National Flood Insurance Program (NFIP) Community Jurisdiction _______________

County(ies). _______________

State. ________________

NFIP Community Number. _______________

NFIP Data Affecting Building/Mobile Home

NFIP Map Number or Community-Panel Number. _______________

NFIP Map Panel Effective/Revised Date. _______________

Is there a Letter of Map Change (LOMC)? _______________

Flood Zone. ______________

No NFIP Map. ________________

Federal Flood Insurance Availability

Complete _______________

Determination

Complete? _______________

Optional Comment. ________________

Reliance on the SFHDF

Did the SFHDF Meet all timing and other requirements? _______________

Determination fees

Were fees handled appropriately? _______________

Introduction

When a lender makes, increases, extends, or renews a loan secured by a building or a mobile home located or to be located in a special flood hazard area, the bank shall mail or deliver a written notice to the borrower and to the servicer in all cases whether or not flood insurance is available under the Act for the collateral securing the loan.

FDIC Regulatory Text Concerning Flood Notice

§ 339.9 Notice of special flood hazards and availability of Federal disaster relief assistance.

(a) **Notice requirement**. When an FDIC-supervised institution makes, increases, extends, or renews a loan secured by a building or a mobile home located or to be located in a special flood hazard area, the FDIC-supervised institution shall mail or deliver a written notice to the borrower and to the servicer in all cases whether or not flood insurance is available under the Act for the collateral securing the loan.

(b) **Contents of notice.** The written notice must include the following information:

(1) A warning, in a form approved by the Administrator of FEMA, that the building or the mobile home is or will be located in a special flood hazard area;

(2) A description of the flood insurance purchase requirements set forth in section 102(b) of the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4012a(b));

(3) A statement, where applicable, that flood insurance coverage is available from private insurance companies that issue standard flood insurance policies on behalf of the NFIP or directly from the NFIP;

(4) A statement that flood insurance that provides the same level of coverage as a standard flood insurance policy under the NFIP may also be available from a private insurance company that issues policies on behalf of the company.

(5) A statement that the borrower is encouraged to compare the flood insurance coverage, deductibles, exclusions, conditions, and premiums associated with flood insurance policies issued on behalf of the NFIP and policies issued on behalf of private insurance companies and that the borrower should direct inquiries regarding the availability, cost, and comparisons of flood insurance coverage to an insurance agent; and

(6) A statement whether Federal disaster relief assistance may be available in the event of damage to the building or mobile home caused by flooding in a Federally declared disaster.

(c) **Timing of notice**. The FDIC-supervised institution shall provide the notice required by paragraph (a) of this section to the borrower within a reasonable time before the completion of the transaction, and to the servicer as promptly as practicable after the FDIC-supervised institution provides notice to the borrower and in any event no later than the time the FDIC-supervised institution provides other similar notices to the servicer concerning hazard insurance and taxes. Notice to the servicer may be made electronically or may take the form of a copy of the notice to the borrower.

(d) **Record of receipt.** The FDIC-supervised institution shall retain a record of the receipt of the notices by the borrower and the servicer for the period of time the FDIC-supervised institution owns the loan.

(e) **Alternate method of notice.** Instead of providing the notice to the borrower required by paragraph (a) of this section, an FDIC-supervised institution may obtain satisfactory written assurance from a seller or lessor that, within a reasonable time before the completion of the sale or lease transaction, the seller or lessor has provided such notice to the purchaser or lessee. The FDIC-supervised institution shall retain a record of the written assurance from the seller or lessor for the period of time the FDIC-supervised institution owns the loan.

(f) **Use of sample form of notice.** An FDIC-supervised institution will be considered to be in compliance with the requirement for notice to the borrower of this section by providing written notice to the borrower containing the language presented in appendix A to this part within a reasonable time before the completion of the transaction. The notice presented in appendix A to this part satisfies the borrower notice requirements of the Act.

Sample Form – Required 1/1/2016

Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance

Appendix A to Part 339—Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance

We are giving you this notice to inform you that:

The building or mobile home securing the loan for which you have applied is or will be located in an area with special flood hazards.

The area has been identified by the Administrator of the Federal Emergency Management Agency (FEMA) as a special flood hazard area using FEMA's Flood Insurance Rate Map or the Flood Hazard Boundary Map for the following community: __________. This area has a one percent (1%) chance of a flood equal to or exceeding the base flood elevation (a 100-year flood) in any given year. During the life of a 30-year mortgage loan, the risk of a 100-year flood in a special flood hazard a

Federal law allows a lender and borrower jointly to request the Administrator of FEMA to review the determination of whether the property securing the loan is located in a special flood hazard area. If you would like to make such a request, please contact us for further information.

___ The community in which the property securing the loan is located participates in the National Flood Insurance Program (NFIP). Federal law will not allow us to make you the loan that you have applied for if you do not purchase flood insurance. The flood insurance must be maintained for the life of the loan. If you fail to purchase or renew flood insurance on the property, Federal law authorizes and requires us to purchase the flood insurance for you at your expense.

- At a minimum, flood insurance purchased must cover the lesser of:

  (1) the outstanding principal balance of the loan; or

  (2) the maximum amount of coverage allowed for the type of property under the NFIP.

Flood insurance coverage under the NFIP is limited to the building or mobile home and any personal property that secures your loan and not the land itself.

- Federal disaster relief assistance (usually in the form of a low-interest loan) may be available for damages incurred in excess of your flood insurance if your community's participation in the NFIP is in accordance with NFIP requirements.

- Although you may not be required to maintain flood insurance on all structures, you may still wish to do so, and your mortgage lender may still require you to do so to protect the collateral securing the mortgage. If you choose not to maintain flood insurance on a structure and it floods, you are responsible for all flood losses relating to that structure.

Availability of Private Flood Insurance Coverage

Flood insurance coverage under the NFIP may be purchased through an insurance agent who will obtain the policy either directly through the NFIP or through an insurance company that participates in the NFIP. Flood insurance that provides the same level of coverage as a standard flood insurance policy under the NFIP may be available from private insurers that do not participate in the NFIP. You should compare the flood insurance coverage, deductibles, exclusions, conditions, and premiums associated with flood insurance policies issued on behalf of the NFIP and policies issued on behalf of private insurance companies and contact an insurance agent as to the availability, cost, and comparisons of flood insurance coverage.

[Escrow Requirement for Residential Loans]

Federal law may require a lender or its servicer to escrow all premiums and fees for flood insurance that covers any residential building or mobile home securing a loan that is located in an area with special flood hazards. If your lender notifies you that an escrow account is required for your loan, then you must pay your flood insurance premiums and fees to the lender or its servicer with the same frequency as you make loan payments for the duration of your loan. These premiums and fees will be deposited in the escrow account, which will be used to pay the flood insurance provider.]

___Flood insurance coverage under the NFIP is not available for the property securing the loan because the community in which the property is located does not participate in the NFIP. In addition, if the non-participating community has been identified for at least one year as containing a special flood hazard area, properties located in the community will not be eligible for Federal disaster relief assistance in the event of a Federally declared flood disaster.

Section 4: Flood Notice Audit

Procedure

Answer all pertinent questions. Remember that properties in a flood zone must get the notice. Other properties are optional, and most banks do not give the notice when not required

Flood Notice

Notice required? _______________.

All required contents present? ________________

Disclosure given timely? ________________

Disclosure properly signed? ________________

Section 5: Flood Insurance Purchase Requirements

General Insurance Purchase Requirement

A bank shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan are covered by flood insurance for the term of the loan. The amount of insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act. Flood insurance coverage under the Act is limited to the replacement value. A bank that acquires a loan from a mortgage broker or other entity through table funding shall be considered to be making a loan for the purposes of this section.

Flood Insurance Purchase and Compliance Requirements

Federal Financial Assistance

Federal officers and agencies are prohibited from approving any financial assistance for acquisition or construction purposes for use in any area:

1. That has been identified as a special flood hazard area, and
2. In which the sale of flood insurance has been made available
3. Unless the building or mobile home and any personal property to which such financial assistance relates is covered by flood insurance
    a. In an amount at least equal to its development or project cost (less estimated land cost) or
    b. To the maximum limit of coverage made available with respect to the particular type of property, whichever is less.

If the financial assistance provided is in the form of a loan or an insurance or guaranty of a loan, the amount of flood insurance required need not exceed the outstanding principal balance of the loan and need not be required beyond the term of the loan. The requirement of maintaining flood insurance applies during the life of the property, regardless of transfer of ownership of such property.

Keep in mind that "financial assistance for acquisition or construction purposes" is any form of financial assistance which is intended in whole or in part for the acquisition, construction, reconstruction, repair, or improvement of any publicly or privately owned building or mobile home and for any machinery, equipment, fixtures, and furnishings contained or to be contained therein. It includes the purchase or subsidization of mortgages or mortgage loans and excludes assistance resulting from the Disaster Relief and Emergency Assistance Act other than assistance under the Act in connection with a flood.

Government-Sponsored Enterprises

Government-Sponsored Enterprises (GSEs) for Housing include the Federal National

Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). These entities are federally chartered corporations whose sole business is to support residential housing by providing a secondary market for mortgages. GSEs are required to implement procedures reasonably designed to ensure that designated loans have flood insurance at the time of origination and at any time during the term of the loan. Under the guidelines of Fannie Mae and Freddie Mac, servicers of loans sold to those agencies are required to assume responsibility for compliance with the mandatory flood insurance requirements.

As secondary market agencies, GSEs have no direct contact or dealings with borrowers, but do have the ultimate exposure on the loan. Consequently, the GSE guidelines are designed to ensure that any "covered loan" they buy has flood insurance for the life of the loan. Freddie Mac and Fannie Mae now require lenders and servicers to keep flood insurance up to date, monitor publication of all future map and community changes, and impose or relieve the mandatory purchase requirement during the term of the loan.

If your bank sells loans to or service loans for Fannie Mae or Freddie Mac, you should consult the most current Selling and Servicing Guides and Announcements (if applicable) for the most recent flood insurance requirements. Lenders who have additional questions regarding flood insurance requirements may contact their Customer Account Manager, Servicing Consultant, or Portfolio Manager.

Nonparticipating Communities

In 1977, the Flood Disaster Protection Act was amended to allow lenders to make conventional loans located in special flood hazard areas, if they were located in nonparticipating communities and as long as the proper notifications (described in the following section) have been provided. A conventional loan is a loan by a private lender, as distinguished from a loan by a Federal government agency that is not secured, insured, or guaranteed by a Federal government agency. Such a loan, even when made by a lender that is regulated by or has its deposits insured by a Federal financial regulatory agency, remains a conventional loan because the loan itself is not secured, insured, or guaranteed by a Federal government agency.

FDIC Regulatory Text Concerning Mandatory Purchase

§ 339.3 Requirement to purchase flood insurance where available.

(a) **In general.** An FDIC-supervised institution shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan. The amount of insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act. Flood insurance coverage under the Act is limited to the building or mobile home and any personal property that secures a loan and not the land itself.

(b) **Table funded loans.** An FDIC-supervised institution that acquires a loan from a mortgage broker or other entity through table funding shall be considered to be making a loan for the purpose of this part.

Coverage Requirements and Limits

The maximum limits of flood insurance coverage available under the NFIP appear below:

Building Coverage	**Emergency Program Availability**	**Maximum Amount Available**
Single family and 2-4 family dwelling	$ 35,000	$250,000
Other residential	$100,000	$250,000
Small business & Multi-Family	$100,000	$500,000
Churches and other nonresidential properties	$100,000	$500,000
Contents coverage (per unit)		
Residential	$ 10,000	$100,000
Small business	$100,000	$500,000
Churches and other properties	$100,000	$500,000

Special limits apply in Alaska, Hawaii, Guam, and the Virgin Islands. For details, and future changes to NFIP coverage limits, refer to page RATE 1 in the NFIP Flood Insurance Manual at:

www.fema.gov/business/nfip/manual.shtm

Acceptable proof of coverage may be a copy of the Flood Insurance Application and premium payment, or a copy of the Declarations Page. The NFIP does not recognize binders or certificates of insurance.

Calculating Coverage

To meet compliance requirements, the amount of flood insurance is the lesser of:

- The outstanding principal balance of the loan(s); or
- The maximum amount of insurance available under the NFIP, which is the lesser of:
  - The maximum limit available for the particular type of structure; or
  - The "insurable value" of the structure, which is the same as 100 percent replacement cost value (RCV). (Unlike the practice in other lines of property insurance, building RCVs under the NFIP do not include market values or the value of the land.)

Section 6: Miscellaneous Flood Insurance Issues

Deductibles

The standard deductible is different for different situations, both the minimum and maximums. Under current law, residential deductibles can be as high as $10,000. Deductibles are applied separately to buildings and again to contents.

Deductibles of $10,000 to $50,000 are available for nonresidential buildings.

Optional deductibles are not available for Preferred Risk Policies. Standard practice in the financial industry is for the lender to dictate the amount of the deductible according to the authority found in the loan document hazard clause. A modification in the deductible can be accomplished at renewal or by endorsement mid-term with the lender's written request.

Lenders may exercise their business judgment prerogative by requiring only the standard deductible to be carried as a safeguard in protecting their interest in the improved real estate. The GSE secondary market members designate what they consider as the proper deductible.

The following table is from the FEMA Guide:

TABLE 8A. MINIMUM DEDUCTIBLES

PROGRAM TYPE	RATING	MINIMUM DEDUCTIBLE FOR COVERAGE OF $100,000 OR LESS[2]	MINIMUM DEDUCTIBLE FOR COVERAGE OVER $100,000
EMERGENCY	All	$1,500	$2,000[3]
REGULAR	All Pre-FIRM Subsidized[4] zones: A, AE, A1–A30, AH, AO, V, VE, and V1–V30, AR/AR Dual zones without Elevation Data	$1,500	$2,000
	All Full-Risk[5] zones: A, AE, A1–A30, AH, AO, V, VE, and V1–V30, AR/AR Dual zones with Elevation Data and B, C, X, A99, and D	$1,000	$1,250
	Tentative and Provisional	$1,000	$1,250

1. The deductible for the PRP, MPPP and Newly Mapped policies will be $1,000 for both building and contents if the building coverage is less than or equal to $100,000 and $1,250 if building coverage is over $100,000. A contents-only policy will have a $1,000 deductible.
2. Use this column if building coverage is $100,000 or less, regardless of the contents coverage amount. This includes policies issued with contents coverage only.
3. In Alaska, Guam, Hawaii, and U.S. Virgin Islands, the coverage amount available is $150,000.
4. Pre-FIRM subsidized policies are those policies covering a Pre-FIRM building that are rated in zones Unnumbered A, AE, A1–A30, AH, AO, VE, and V1–V30 without elevation data from an Elevation Certificate. Also included among Pre-FIRM subsidized policies are policies covering certain Pre-FIRM buildings rated in zones D and Unnumbered V, for which the Pre-FIRM subsidized rate remains more favorable than full-risk rating in zone D or Unnumbered V.

5. Full-Risk rates apply to all policies rated with elevation data from an Elevation Certificate in zones Unnumbered A, AE, A1–A30, AH, AO, VE, and V1–V30, regardless of whether the building is Pre-FIRM or Post-FIRM. Post-FIRM buildings rated in zones D or Unnumbered V, and Pre-FIRM buildings in zones D or Unnumbered V using Post-FIRM rate tables are considered Full-Risk. Full-Risk rates are also applied to all policies rated in zones B, C, or X, regardless of product type or the building classification as Pre-FIRM or Post-FIRM. Grandfathered standard-X zone policies, and grandfathered policies using elevation data from an Elevation Certificate are considered Full-Risk.

Relevant FAQs

17. Can a lender allow the borrower to use the maximum deductible to reduce the cost of flood insurance?

Answer: Yes. However, it is not a sound business practice for a lender to allow the borrower to use the maximum deductible amount in every situation. A lender should determine the reasonableness of the deductible on a case-by-case basis, taking into account the risk that such a deductible would pose to the borrower and lender. A lender may not allow the borrower to use a deductible amount equal to the insurable value of the property to avoid the mandatory purchase requirement for flood insurance.

The Possibility of Different Coverage Requirements

Because the 1973 Act sets only the minimum coverages, each federal agency has the right to require higher limits as deemed appropriate. For example, the Small Business Administration (SBA) requires flood insurance up to the value of a property or the maximum amount of insurance that can be purchased, whichever is less, regardless of the amount of the loan. The Federal National Mortgage Association (FNMA), on the other hand, requires the amount of flood insurance to be equal to the lesser of 100 percent of the insurable value of the facilities or the maximum coverage available.

Instead of establishing minimum amounts of coverage to comply with the federal agencies' requirements, it is suggested that the lender establish its own guidelines as they apply to the local needs of the community and the lender.

Assignment of Policy

There is a 30-day waiting period before coverage can go into effect when an NFIP policy is assigned from a seller to a buyer where the buyer does not obtain a mortgage. If the buyer obtains a mortgage, the waiting period does not apply.

Section 7: Flood Insurance Purchase Requirements Audit

Procedure

Complete these questions as applicable.

Flood Insurance Purchase and Compliance Requirements

Is flood insurance required? _______________

If required and sold to a GSE, were the GSE standards met? _______________

Is coverage adequate? _______________

Were all deductible requirements met? _______________

Section 8: Flood Insurance Escrow Requirement

Introduction

The Agencies now require a regulated lending institution, or a servicer acting on behalf of a regulated lending institution, to escrow all premiums and fees for required flood insurance, unless the loan or the lending institution qualifies for one of the statutory exceptions. The Agencies adopted a final rule (quoted below) that will implement the escrow requirement of the FDPA, as amended.

The escrow requirement applies to any loan secured by residential improved real estate or a mobile home that hits a MIRE on or after January 1, 2016. Any loan which experiences a triggering event (MIRE) on or after that date will be subject to these requirements. Therefore, it is possible that some loans which are not subject to a flood insurance escrow may become subject to an escrow after January 1, 2016. A map change is not a triggering event. Therefore, lenders would not be required to escrow flood insurance premiums and fees based solely on that change.

Loan-Related Exceptions

There are several exceptions to the general escrow requirement. These exceptions include:

- loans that are in a subordinate position to a senior lien secured by the same property for which flood insurance is being provided;
- loans secured by residential improved real estate or a mobile home that is part of a condominium, cooperative, or other project development, provided certain conditions are met;
- loans that are secured by residential improved real estate or a mobile home that is used as collateral for a business purpose;
- home equity lines of credit;
- nonperforming loans; and
- loans with terms not longer than 12 months.

These exceptions are in addition to the small lender exception applicable to banks that have total assets of less than $1 billion.

There is no duty for a bank or servicer to evaluate the applicability of the subordinate lien exception, or any of the other exceptions. However, similar to the force placement provisions relating to the mandatory flood insurance purchase requirement, when a lender makes a determination that the subordinate lien exception no longer applies, for example, when it receives notice that the senior lien has been paid off or when it conducts the required inquiry at a triggering event, then the lender must begin escrowing flood insurance premiums and fees. Therefore, lenders should ensure that the loan documents executed in connection with a subordinate loan permit the lender to require an escrow in connection with the loan in the event the loan takes a first lien position and becomes subject to the escrow requirement.

The law excepts from the escrow requirement loans secured by residential improved real estate or a mobile home that is part of a condominium, cooperative, or other project development when covered by a flood insurance policy that:

- meets the mandatory flood insurance purchase requirement;
- is provided by the condominium association, cooperative, homeowners association or other applicable group; and
- the premium for which is paid by the condominium association, cooperative, homeowners association, or other applicable group as a common expense.

If the amount of the policy purchased by the condominium association, cooperative, homeowners association, or other applicable group does not satisfy the mandatory flood insurance purchase requirement, then the borrower would be required to obtain a supplemental policy to cover the deficiency. In those instances, the regulated lending institution must escrow the premiums and fees for the supplemental policy unless the small lender exception applies.

There is also a statutory exception from the escrow requirement for home equity lines of credit (HELOCs).

The underlying law also includes an exception from the escrow requirement for nonperforming loans (90 days past due). The Agencies believe further clarification is required regarding this exception. The Agencies adopted language that is adapted from the FCA's regulations on categorizing assets to provide that a nonperforming loan is a loan that is 90 or more days past due and remains nonperforming until it is permanently modified or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

The final exception is for a loan that has a term of not to exceed 12 months. If a loan of 12 months or less is extended or renewed for an additional term of 12 months or less, the Agencies' regulations would permit the exception to apply to the extended or renewed loan because an extension or renewal is a triggering event. Therefore, at the time of the triggering event, the regulated lending institution may apply the exception if the term of the newly extended or renewed loan is for a term of 12 months or less.

If a bank, or its servicer, determines at any time during the term of a designated loan secured by residential improved real estate or a mobile home that experiences a MIRE on or after January 1, 2016, that an exception does not apply, then the lender or its servicer must require the escrow of all flood insurance premiums and fees as soon as reasonably practicable. If the loan is subject to RESPA, all pertinent RESPA rules and disclosures will apply.

Small Lender Exception

In addition to the exceptions to the escrow requirement discussed above, the statutes contain an exception for certain small lenders. The FDPA, as amended, states that, except as provided by State law, banks that have total assets of less than $1 billion are excepted from the escrow requirement if, on or before July 6, 2012, the institution:

- in the case of a loan secured by residential improved real estate or a mobile home, was not required under Federal or State law to deposit taxes, insurance premiums, fees, or any other charges in an escrow account for the entire term of the loan, and

- did not have a policy of consistently and uniformly requiring the deposit of taxes, insurance premiums, fees, or any other charges in an escrow account for loans secured by residential improved real estate or a mobile home.

Because Biggert-Waters does not specify a point in time to measure the asset size of an institution to determine whether it qualifies for the exception, the Agencies proposed that a regulated lending institution may qualify for the exception if it has total assets of less than $1 billion as of December 31 of either of the two prior calendar years. There is no current statutory authority to adjust the asset size for inflation.

When a bank exceeds the $1 billion asset-size threshold, the bank will have six months to make all appropriate changes for its new status. A bank would be required to escrow flood insurance premiums and fees for any loans made, increased, extended, or renewed on or after July 1 of the succeeding calendar year after a regulated lending institution has a change in status.

Based on the Agencies' regulation, a regulated lending institution could technically reclaim small lender status. However, given the burden that a regulated lending institution would undertake to establish an escrow program, the Agencies question whether an institution would find it appropriate to abandon a program in which it has invested resources to develop and risk causing confusion to borrowers who have grown accustomed to escrowing flood insurance premiums and fees, especially if the institution could lose the small lender exception again in the future.

Notice

A bank, or a servicer acting on its behalf, must mail or deliver a written notice informing a borrower that it is required to escrow all premiums and fees for required flood insurance on residential improved real estate. The purpose of the notice ensures that borrowers are informed about the requirement to escrow premiums and fees for mandatory flood insurance.

This notice is included in the 2016 and following version of the Notice of Special Flood Hazards. This would help minimize the burden to banks providing this notice and ensure that borrowers receive the notice at a time when they are considering the purchase of flood insurance. A bank or its servicer must require the escrow of all flood insurance premiums and fees if the lender, or a servicer determines at any time during the term of a loan that an exception to the escrow requirement for the loan no longer applies.

To alert borrowers to the potential need to escrow in those circumstances, the Agencies also are requiring lenders to provide the escrow notice in connection with any excepted loan that could lose its exception during the term of the loan. Consequently, borrowers of loans that may eventually become subject to the escrow requirement will be informed of that possibility.

Option to Escrow

HFIAA requires banks to offer and make available to a borrower the option to escrow flood insurance premiums and fees for loans secured by residential improved real estate or a mobile home that are outstanding as of January 1, 2016. The initial distribution of this notice must be completed by June 30, 2016.

The option to escrow does not apply to loans or lenders that are exempted from the general escrow requirement. If a loan already includes flood escrow, there would be no need for a notice to these customers.

Banks that no longer qualify for the small lender exception must provide the option to escrow for borrowers of loans outstanding on July 1 of the succeeding calendar year following the lender's change in status.

To facilitate compliance, the Agencies proposed a model clause for this notice in Appendix B. Appendix B is located at the end of this section.

FDIC Regulatory Text Concerning Escrow Requirements

§ 339.5 Escrow requirement.

(a) **In general.**

(1) **Applicability.** Except as provided in paragraphs (a)(2) or (c) of this section, an FDIC-supervised institution, or a servicer acting on its behalf, shall require the escrow of all premiums and fees for any flood insurance required under § 339.3(a) for any designated loan secured by residential improved real estate or a mobile home that is made, increased, extended, or renewed on or after January 1, 2016, payable with the same frequency as payments on the designated loan are required to be made for the duration of the loan.

(2) **Exceptions.** Paragraph (a)(1) of this section does not apply if:

(i) The loan is an extension of credit primarily for business, commercial, or agricultural purposes;

(ii) The loan is in a subordinate position to a senior lien secured by the same residential improved real estate or mobile home for which the borrower has obtained flood insurance coverage that meets the requirements of § 339.3(a);

(iii) Flood insurance coverage for the residential improved real estate or mobile home is provided by a policy that:

(A) Meets the requirements of § 339.3(a);

(B) Is provided by a condominium association, cooperative, homeowners association, or other applicable group; and

(C) The premium for which is paid by the condominium association, cooperative, homeowners association, or other applicable group as a common expense;

(iv) The loan is a home equity line of credit;

(v) The loan is a nonperforming loan, which is a loan that is 90 or more days past due and remains nonperforming until it is permanently modified or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full; or

(vi) The loan has a term of not longer than 12 months.

(3) **Duration of exception**. If an FDIC-supervised institution, or a servicer acting on its behalf, determines at any time during the term of a designated loan secured by residential improved real estate or a mobile home that is made, increased, extended, or renewed on or after January 1, 2016, that an exception under paragraph (a)(2) of this section does not apply, then the FDIC-supervised institution or its servicer shall require the escrow of all premiums and fees for any flood insurance required under § 339.3(a) as soon as reasonably practicable and, if applicable, shall provide any disclosure required under section 10 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2609) (RESPA).

(4) **Escrow account.** The FDIC-supervised institution, or a servicer acting on its behalf, shall deposit the flood insurance premiums and fees on behalf of the borrower in an escrow account. This escrow account will be subject to escrow requirements adopted pursuant to section 10 of RESPA, which generally limits the amount that may be maintained in escrow accounts for certain types of loans and requires escrow account statements for those accounts, only if the loan is otherwise subject to RESPA. Following receipt of a notice from the Administrator of FEMA or other provider of flood insurance that premiums are due, the FDIC-supervised institution, or a servicer acting on its behalf, shall pay the amount owed to the insurance provider from the escrow account by the date when such premiums are due.

(b) **Notice.** For any loan for which an FDIC-supervised institution is required to escrow under paragraph (a) or paragraph (c)(2) of this section or may be required to escrow under paragraph (a)(3) of this section during the term of the loan, the FDIC-supervised institution, or a servicer acting on its behalf, shall mail or deliver a written notice with the notice provided under § 339.9 informing the borrower that the FDIC-supervised institution is required to escrow all premiums and fees for required flood insurance, using language that is substantially similar to model clauses on the escrow requirement in appendix A.

(c) **Small lender exception.**

(1) **Qualification.** Except as may be required under applicable State law, paragraphs (a), (b) and (d) of this section do not apply to an FDIC-supervised institution:

(i) That has total assets of less than $1 billion as of December 31 of either of the two prior calendar years; and

(ii) On or before July 6, 2012:

(A) Was not required under Federal or State law to deposit taxes, insurance premiums, fees, or any other charges in an escrow account for the entire term of any loan secured by residential improved real estate or a mobile home; and

(B) Did not have a policy of consistently and uniformly requiring the deposit of taxes, insurance premiums, fees, or any other charges in an escrow account for any loans secured by residential improved real estate or a mobile home.

(2) **Change in status**. If an FDIC-supervised institution previously qualified for the exception in paragraph (c)(1) of this section, but no longer qualifies for the exception because it had assets of $1 billion or more for two consecutive calendar year ends, the FDIC-supervised institution must escrow premiums and fees for flood insurance pursuant to paragraph (a) for any designated loan made, increased, extended, or renewed on or after July 1 of the first calendar year of changed status.

(d) **Option to escrow.**

(1) **In general.** An FDIC-supervised institution, or a servicer acting on its behalf, shall offer and make available to the borrower the option to escrow all premiums and fees for any flood insurance required under § 339.3 for any loan secured by residential improved real estate or a mobile home that is outstanding on January 1, 2016, or July 1 of the first calendar year in which the FDIC-supervised institution has had a change in status pursuant to paragraph (c)(2) of this section, unless:

(i) The loan or the FDIC-supervised institution qualifies for an exception from the escrow requirement under paragraphs (a)(2) or (c) of this section, respectively;

(ii) The borrower is already escrowing all premiums and fees for flood insurance for the loan; or

(iii) The FDIC-supervised institution is required to escrow flood insurance premiums and fees pursuant to paragraph (a) of this section.

(2) **Notice.** For any loan subject to paragraph (d) of this section, the FDIC-supervised institution, or a servicer acting on its behalf, shall mail or deliver to the borrower no later than June 30, 2016, or September 30 of the first calendar year in which the FDIC-supervised institution has had a change in status pursuant to paragraph (c)(2) of this section, a notice in writing, or if the borrower agrees, electronically, informing the borrower of the option to escrow all premiums and fees for any required flood insurance and the method(s) by which the borrower may request the escrow, using language similar to the model clause in appendix B.

(3) **Timing**. The FDIC-supervised institution or servicer must begin escrowing premiums and fees for flood insurance as soon as reasonably practicable after the FDIC-supervised institution or servicer receives the borrower's request to escrow.

Appendix B to Part 339 – SAMPLE CLAUSE FOR OPTION TO ESCROW FOR OUTSTANDING LOANS

Escrow Option Clause

You have the option to escrow all premiums and fees for the payment on your flood insurance policy that covers any residential building or mobile home that is located in an area with special flood hazards and that secures your loan. If you choose this option:

- Your payments will be deposited in an escrow account to be paid to the flood insurance provider.
- The escrow amount for flood insurance will be added to the regular mortgage payment that you make to your lender or its servicer.
- The payments you make into the escrow account will accumulate over time and the funds will be used to pay your flood insurance policy when your lender or servicer receives a notice from your flood insurance provider that the flood insurance premium is due.

To choose this option, follow the instructions below. If you have any questions about the option, contact [Insert Name of Lender or Servicer] at [Insert Contact Information].

[Insert Instructions for Selecting to Escrow]

Section 9: Flood Insurance Escrow Requirement Audit

Introduction

Answer the following questions as applicable.

Escrow

Is the loan exempted from escrow due to loan type, etc.? _______________

Is the loan exempted from escrow due to small lender exception? _______________

Section 10: Force Placement

Introduction

This would normally not be part of an audit, and is included for your reference.

If a bank, or a servicer acting on behalf of the bank, determines at any time during the term of a designated loan that the building or mobile home and any personal property securing the designated loan is not covered by flood insurance or is covered by flood insurance in an amount less than the amount required, then the bank or its servicer shall notify the borrower that the borrower should obtain flood insurance, at the borrower's expense, in an amount at least equal to the amount required, for the remaining term of the loan. If the borrower fails to obtain flood insurance within 45 days after notification, then the bank or its servicer shall purchase insurance on the borrower's behalf. The bank or its servicer may charge the borrower for the cost of premiums and fees incurred in purchasing the insurance.

A sample notice appears at the end of this section.

Force placement applies to any borrower of a designated loan, commercial or residential, whether or not escrow of expenses is required. On any type of force placed policy, a lender should keep evidence of the determination that the loan is in an SFHA, including information concerning the FIRM panel and method by which the determination was made.

Home equity and second mortgage loans also are included under the requirement. A secondary lienholder that force places coverage only to the extent of its loan will not protect its interest if a first mortgagee claims priority to any insurance proceeds.

Force placement by a second mortgagee will require coordination with the first mortgagee, as well as with the insurance producer and insurer on the first mortgage, if one exists.

The 1994 Reform Act requires a lender to carry out the force placement as a matter of law, independent of the contractual provisions of the loan. Force placement is not limited to those situations provided for under the mandatory purchase law. The standard Fannie Mae and Freddie Mac documents provide that the lender may obtain the force-placed insurance at the borrower's expense.

The amount of insurance coverage must be at least the lowest of the outstanding principal balance of the loan(s), the insurable value of the structure, or the maximum limit available under the NFIP. If the lender opts to protect only its security in the loan (loan balance), the insurance proceeds may be inadequate. Force placement of flood insurance is intended only as a last resort, and on mortgages whose mortgagors have failed to respond to the notifications required by law.

The 1994 Reform Act provides that a lender must inform its borrowers that they have a free choice of an insurer from whom to purchase coverage. That free-choice purchase option also applies to a lender when dealing with force-placed coverage. If, within 45 days from the initial notice, a borrower fails to comply by voluntarily obtaining coverage, a lender or servicer must obtain either:

- A Mortgage Portfolio Protection Program (MPPP) policy through a WYO insurer; or
- An SFIP through either a WYO insurer or the NFIP Servicing Agent; or
- Non-NFIP flood coverage from a private industry insurer if such coverage is available.

FDIC Regulatory Text Concerning Force Placement of Flood Insurance

§ 339.7 Force placement of flood insurance.

(a) **Notice and purchase of coverage.** If an FDIC-supervised institution, or a servicer acting on its behalf, determines at any time during the term of a designated loan, that the building or mobile home and any personal property securing the designated loan is not covered by flood insurance or is covered by flood insurance in an amount less than the amount required under § 339.3, then the FDIC-supervised institution or its servicer shall notify the borrower that the borrower should obtain flood insurance, at the borrower's expense, in an amount at least equal to the amount required under § 339.3, for the remaining term of the loan. If the borrower fails to obtain flood insurance within 45 days after notification, then the FDIC-supervised institution or its servicer shall purchase insurance on the borrower's behalf. The FDIC-supervised institution or its servicer may charge the borrower for the cost of premiums and fees incurred in purchasing the insurance, including premiums or fees incurred for coverage beginning on the date on which flood insurance coverage lapsed or did not provide a sufficient coverage amount.

(b) **Termination of force-placed insurance.**

(1) **Termination and refund.** Within 30 days of receipt by an FDIC-supervised institution, or a servicer acting on its behalf, of a confirmation of a borrower's existing flood insurance coverage, the FDIC-supervised institution or its servicer shall:

(A) Notify the insurance provider to terminate any insurance purchased by the FDIC-supervised institution or its servicer under paragraph (a) of this section; and

(B) Refund to the borrower all premiums paid by the borrower for any insurance purchased by the FDIC-supervised institution or its servicer under paragraph (a) of this section during any period during which the borrower's flood insurance coverage and the insurance coverage purchased by the FDIC-supervised institution or its servicer were each in effect, and any related fees charged to the borrower with respect to the insurance purchased by the FDIC-supervised institution or its servicer during such period.

(2) **Sufficiency of demonstration.** For purposes of confirming a borrower's existing flood insurance coverage under paragraph (b) of this section, an FDIC-supervised institution or its servicer shall accept from the borrower an insurance policy declarations page that includes the existing flood insurance policy number and the identity of, and contact information for, the insurance company or agent.

Follow Up

National flood insurance is written on an annual basis. Thus, the bank is required to ensure that the customer maintains the insurance for the duration of the loan. This means annual verification is required. Failure to require and verify the insurance could lead to the bank's being sued for noncompliance with the law and therefore being liable for any losses suffered by the customer in a flood.

Sample Force Placement Notice

NOTICE OF FLOOD INSURANCE REQUIREMENT

Dear Customer:

Our records indicated that the property securing your loan is located in a Special Flood Hazard Area (SFHA) and that flood insurance is required to be maintained on the property for the entire term of the loan. As of this date, we have not received evidence that a current flood insurance policy is in place.

If you have already purchased flood insurance, please forward to us a copy of the policy or the application form along with a paid receipt.

The flood insurance policy submitted must contain flood coverage for at least the current amount of your loan or the maximum amount available from the National Flood Insurance Program (NFIP).

We must receive your evidence of flood insurance within the next 45 days or it will be necessary for us to obtain a flood insurance policy protecting our interest in the property.

If we are forced to obtain flood insurance on your behalf, the amount we will purchase and cost is shown below:

Amount of Insurance	Deductible	Annual Premium
$XX,XXX	$X,XXX	$XXX.XX

Please be aware that flood insurance we obtain may be more expensive than a policy you could obtain on your own and will provide coverage for only the physical damage to the building due to flood and will not include other coverage, such as contents and personal liability.

Regards,

Lender