



Consumer Compliance
Division of Banking Supervision and Regulation

Consumer Compliance “Hot Topics”

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Flood Insurance Compliance

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Contents

- **Flood Insurance Challenges**
 - Common Flood Violations
- **Civil Money Penalties**
 - What's a Pattern or Practice
- **Master or Blanket Insurance Policy**
 - Key items to consider
- **Flood Management**
 - What to do to ensure an effective program
- **Flood Resources**
 - Useful web sites and contacts

Flood Insurance Challenges

- The majority of compliance examinations performed by FRBSF in 2006 and 2007 have identified substantive violations of the flood insurance provisions of Regulation H
- Common Violations:
 - Adequate insurance not in place at closing
 - Multiple buildings not insured
 - Contents not insured
 - Insurance not maintained for the life of the loan
 - 45-day notification not provided before force placing insurance
 - Master or blanket insurance policies not in compliance with rules

Civil Money Penalties

- Regulators are required to assess civil money penalties when a pattern or practice of violations exists
- What's a Pattern or Practice?
 - Repeated, intentional, regular, usual, deliberate, or institutionalized practices generally WILL be considered a pattern or practice
 - Isolated, unrelated, or accidental occurrences generally NOT a pattern or practice
- Factors Considered
 - Common source or cause of the violations
 - Relationship of instances to one another
- Costs
 - Civil money penalties of up to \$385 per violation with a maximum of \$125,000 per calendar year
 - Other costs - legal counsel; file searches; notifying borrowers; reputational risk

Master or Blanket Insurance Policy

- A blanket, lender-paid insurance policy is not an acceptable substitute for borrower-paid flood insurance
- Provides the lender with coverage, but does not meet the requirements or intent of the NFIP – **to protect the borrower**
- The policy must guarantee that the flood insurance coverage, considering deductibles, exclusions, and conditions (e.g., assignable) offered by the insurer, is at least as broad as the coverage under the SFIP (Standard Flood Insurance Policy)

Strengthen Your Flood Management Program by

- Reviewing your policies and procedures for flood hazard insurance
- Ensuring that you have adequate monitoring systems in place to identify lapses in coverage
- Sampling loans – new originations and renewals – to ensure adequate and timely coverage
- Training staff
- Keeping senior management and the board of directors informed with periodic MIS

Flood Resources

- FEMA website
 - www.fema.gov
- National Flood Insurance Program website
 - www.floodsmart.gov
- Examination Procedures
 - www.federalreserve.gov/boarddocs/supmanual/cch/200601/flood.pdf
- For hurricane-related flooding:
 - FRB Board Updates - www.federalreserve.gov/hurricanekatrina.htm
 - FDIC Hurricane Recovery Information - www.fdic.gov/hurricane/index.html
 - OCC's Hurricane Central - www.occ.treas.gov/hurricane.htm

Community Reinvestment Act: Intermediate Small Banks and the Proposed Questions and Answers

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Contents

- **Common Pitfalls**
 - What we're seeing in the field
- **Intermediate Small Bank (ISB) Examination Method**
 - Key items to consider
- **Illegal Credit Practices and your CRA Rating**
 - Importance of a sound compliance and fair lending program
- **Interagency CRA Q&As (proposed)**
 - Selected excerpts from the proposal
- **Community Development Resources**
 - Useful web sites

Common Pitfalls

- No Community Development strategy
 - Limited monitoring/tracking of community development activities.
 - Less than “ready access” to qualifying documentation.
- Knowledge gaps
 - CRA definitions for and how to qualify community development loans, investments, and services.
 - Community development needs and opportunities in market that provide support for distribution of CD activities

Intermediate Small Bank (ISB)

- ISB eligible banks
 - What factors should I consider before election?
- Transitioning from small bank to ISB (or large bank)
- Importance of performance context
- Implications of “Needs Improvement” rating under either test

Illegal Credit Practices and CRA

- Discrimination or illegal credit practices can adversely affect CRA rating
- Regulators will determine extent to which these practices impact the bank's ability to meet community credit needs
- Importance of a sound fair lending program to mitigate exposure

Interagency CRA Q&As (proposed)

- Discusses how examiners will weigh quantitative and qualitative performance criteria
- Provides enhanced opportunities to engage in qualified community development activities outside of delineated assessment area(s)
- Discusses how opening or maintaining branches in LMIs or designated disaster areas would receive CD service consideration
- Clarifies ISB eligibility requirements and how certain loans would qualify as community development loans under CD Test

Community Development Resources

- Federal Reserve Bank of San Francisco website
 - <http://www.frbsf.org/cdinvestments>
- Federal Financial Institution Examination Council website
 - <http://www.ffiec.gov/cra/examinations.htm>
- Proposed Interagency CRA Q&A: Federal Register/ Vol. 72, No. 132
 - <http://edocket.access.gpo.gov/2007/pdf/07-3223.pdf>

Fair Lending Risk in Indirect Auto Lending

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Contents

- **Indirect Auto Lending Relationship**
 - Typical Relationship Characteristics
- **Are you the Creditor?**
 - Creditor Defined & Recent Court Rulings
- **Where is the Risk?**
 - Dealer Markup
- **Managing the Risk**
 - Due Diligence, Controls & Monitoring
- **Resources for Further Reading**
 - Useful articles, web sites and contacts

Indirect Auto Lending Relationship

- Lender extends credit to automobile purchasers through dealers that originate loans on the lender's behalf.
- Indirect programs typically incorporate two components into the annual percentage rate (APR) charged to the customer: the "Buy Rate" and the "Dealer Markup."
- The Buy Rate is established by the lender based on the customer's credit worthiness.
- The Dealer Markup is included in the contract APR and paid by the customer to the lender without the customer's knowledge.
- A portion of the Dealer Markup is then rebated back to the dealer and the remaining portion is retained by the lender.

Definition of Creditor

- Creditor defined by Regulation B (Equal Credit Opportunity Act)
 - “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.”
- Court Rulings
 - Courts have found that lenders working with auto dealers are creditors and that may still face liability even as assignees.
 - Courts have ruled that lenders have acted as creditors by providing the buy rate for loans and authorizing dealers to negotiate markups.

Where is the Risk?

- The dealer markup is the difference between a lender's buy rate and the contract rate charged to the customer.
- The markup creates risk because it results in the cost of credit being determined by factors other than the consumer's credit history.
- Dealer markups can give rise to claims that either individual dealers or the actions of all dealers collectively have resulted in disparate treatment of a protected class.

Managing the Risk

- Due Diligence
 - Review dealer's written policies and guidelines.
 - Review a sample of transactions prior to entering into an arrangement with a dealer.
- Controls
 - Require dealers to sign written agreements stating that they will comply with applicable fair lending laws and regulations.
 - Cap dealer markups to help ensure that pricing differences will be limited.
 - Develop procedures to prevent pricing in excess of established caps.

Managing the Risk (continued)

- Monitoring
 - Monitor and document exceptions to the buy rate as well as the cap rates.
 - Analyze dealer markups to ensure that statistical disparities correlated with race or other protected classes do not exist.
 - Review overall portfolio as well as the activity of individual dealerships.
 - Review the average overage as well as the frequency of overages charged to protected classes.
- Use a Risk Focused Approach to Monitoring
 - Review dealers located in demographically diverse areas.
 - Review high volume dealers versus dealers with nominal volume.

Indirect Auto Lending Resources

- The following American Bankers Association article published in the July 2003 ABA Banking Journal provides additional information on how to manage risks associated with third-party lending relationships:

“Cutting the Risks Built into Third-Party Lending Relationships”, by Anand S. Ramand, Joseph L. Barloom, and Mathew D. Michael, attorneys for Skadden, Arps, Slate Meagher & Flom LLP., Washington, D.C.

- Applicable court cases can be viewed at the following websites:
 - National Consumer Law Center at http://www.consumerlaw.org/issues/cocounseling/examples_litigation.shtml#auto
 - Lief Cabraser Law firm at <http://www.lieffcabraser.com/auto-loan-discrimination.htm>

Questions?



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