Interagency Compliance and CRA Hot Topics Roundtables

Spring 2004

The FACT Act

Fair Credit Reporting Act

- Amended in 1996 to provide federal preemption of state law
- Regulates consumer reporting agencies
- Contained a sunset provision, with preemption expiring December 31, 2003
- Congress looked at extending provision or making it permanent

Fair Credit Reporting Act

- Several initiatives proposed regarding preemption
- Final legislation passed on December 4, 2003
- New legislation called Fair and Accurate Credit Transactions Act (“FACT Act”)
- Provides permanent preemption, effective December 31, 2003

FACT Act

- Provisions generally have one of two effective dates:
  - March 31, 2004: for provisions that can be implemented more quickly
  - December 1, 2004: for provisions that require changes to existing operating systems, disclosures, forms or practices
- In one case, effective date will depend on the effective date of the implementing regulation

FACT Act

1. Identify Theft Prevention
2. Furnisher Responsibilities
3. Risk-based Pricing
4. Affiliate Sharing
5. Disclosure of Communications to a Consumer Reporting Agency
6. Credit Score Disclosure
7. Statute of Limitations
8. Disposal of Consumer Report Information and Records
9. Reconciliation of Address

FACT Act

1. Identity Theft Prevention

   A. Improved Access to Credit Reports

   B. “Red Flag” Guidelines

   C. Fraud Alerts/Active Duty Indicator

   D. Identity Theft Victim Rights

FACT Act

A. Improved Access to Credit Reports

- Section 211
- Provides every consumer the right to a free credit report
- Final regulation issued June 4, 2004
- Rollout will begin in the West (free reports available December 1, 2004) and stagger eastward

FACT Act

B. “Red flag” guidelines

- Section 114
- Requires federal banking agencies establish guidelines to combat identity theft
- Effective March 31, 2004

FACT Act

C. Fraud Alerts/Active Duty Indicator

- Section 112
- Any consumer who believes he/she is the victim of credit fraud may request a fraud alert be placed in his/her file for 90 days
- Consumer can also request an “extended alert” for up to 7 years
- Effective March 31, 2004

FACT Act

D. Identity Theft Victims Rights

- Section 151
- Credit bureaus will be required to provide a notice to each consumer who has reported that he/she is a victim of identity theft
- Effective March 31, 2004

FACT Act

2. Furnisher Responsibilities

   A. Procedures to Enhance Accuracy and Integrity of Information

   B. Prevention of “Re-pollution” of Consumer Reports

FACT Act

A. Procedures to Enhance Accuracy and Integrity of Information

- Section 312
- The regulators must establish guidelines to enhance the accuracy and integrity of information that is provided to credit reporting agencies
- This section also addresses what a furnisher of information must do after receiving a dispute from a consumer
- Effective March 31, 2004

FACT Act

B. Prevention of “Re-pollution” of Consumer Reports

- Section 154
- Requires that furnishers of information have procedures in place to ensure that blocked information is not resubmitted
- Effective March 31, 2004

FACT Act

3. Risk-based Pricing

- Section 311
- Lenders must provide notices when they:
  - Use consumer reports, and
  - Grant credit on terms that are “materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through” that lender
- Effective March 31, 2004

FACT Act

4. Affiliate Sharing

- Creates stand-alone section allowing consumers to opt-out of information-sharing agreements among affiliates
- Before, this was implied in the definition of what constituted a “credit report”
- Effective date will be incorporated into the implementing regulation
  - Implementing regulation due by September 4, 2004

FACT Act

5. Disclosure of Communications to a Consumer Reporting Agency

- Section 217
- Lenders must notify consumers when negative information is provided to a consumer reporting agency
- Final regulation issued June 8, 2004; effective July 16, 2004
- Lenders can either (1) provide a blanket notice to all customers before submitting negative information, or (2) provide case-by-case notices after the negative information has been submitted

FACT Act

6. Credit Score Disclosure

- Section 212
- Consumer reporting agencies must provide credit score information to consumers on request
- Effective March 31, 2004

FACT Act

7. Statute of Limitations

- Section 156
- Extends statute of limitations for Fair Credit Reporting Act violations
- Used to be 2 years after the event
- Now, 2 years after <u>discovery</u> of the event
- Effective March 31, 2004

FACT Act

8. Disposal of Consumer Report Information and Records

   – Section 216

   – Notice of Proposed Rulemaking issued June 8, 2004; comments due by July 23

   – The agencies propose that lenders apply the existing “Interagency Guidelines on Safeguarding Customer Information” when disposing consumer report information and records

   – Effective December 1, 2004

FACT Act

9. Reconciliation of Address

- Section 315
- Consumer reporting agencies must notify users of addresses that don't match
- Effective March 31, 2004

FACT Act

Medical Information

- Section 411
- An implementing regulation was proposed on April 26, 2004; the comment period is closed
- The proposal would add two new sections:
  - The first would limit the inclusion of medical information on credit reports (applicable to credit reporting agencies)
  - The second would prohibit creditors from using medical information when evaluating eligibility for credit

The Changing World of HMDA

Major Changes - 2003

- Effective January 1, 2003
- Use 2000 Census data to geo-code applications for 2003 LAR
- Collect and report race and gender information for telephone applications
  - Use existing race codes for 2003 applications
  - Use new format for 2004 applications

Major Changes - 2004

- Broader coverage
  - Expanded for non-depository lenders
  - New MSA designations effective January 1, 2004; significant changes will result in new reporters.
- Pre-approvals reportable
- Manufactured home loan flag
- Revised definitions
  - Refinancings
  - Home Improvement loan
- Format for race and ethnicity data modified
- Rate spread
- HOEPA status
- Lien position

Non-Depository Lenders §203.2(e)

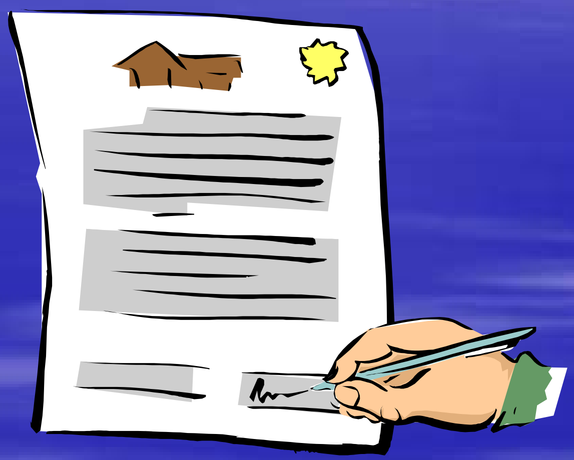
- Dollar-volume threshold test adopted to determine HMDA coverage for non-depository lenders

New MSA Designations

- Applies to both HMDA and CRA data
- Research and get data for this slide – metropolitan / micropolitan / etc.

New Definitions
Pre-Approval/Application - §203.2(b)(2)

A pre-approval is an application when:



- There is a defined loan program
- It involves a decision based on comprehensive credit underwriting
- The creditor issues either a binding written commitment
  - Specific amount and time period
  - Involves a ***limited set of conditions***
- The creditor denies the request and issues an adverse action notice

Allowable Pre-Approval Conditions

Limited conditions are those unrelated to the financial condition or creditworthiness of the applicant such as certification of a clear termite inspection

Reporting Pre-Approvals

- Report only home purchase loans
- Report originations that began as pre-approval requests
- Report pre-approval if denied
- Optional Reporting
  - Requests that were approved but not accepted
- Do not report requests that were withdrawn or incomplete

Manufactured Homes - §203.2(i)

- Required to designate whether the application or loan involved a manufactured home
- Use the HUD definition of manufactured home
- Make reasonable efforts
- Report 1-4 family when unable to determine through reasonable efforts

HUD Definition
Manufactured Home (24 CFR 3280.2)

"A structure, transportable in one or more sections, which in the traveling mode, is eight body feet or more in width or forty body feet or more in length, or when erected on a site, is three hundred twenty or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation, when connected to the required utilities, and includes the plumbing, heating, air conditioning, and electrical systems contained therein."

HUD Definition
Manufactured Home (24 CFR 3280.2)
(Continued)

- New commentary explains that the HUD code requires generally that housing be essentially ready for occupancy upon leaving the factory and being transported to a building site
- Modular homes meet the definition
- Other factory-built homes, such as panelized and pre-cut homes, generally do not

Refinance - §203.2(k)

- Currently, lenders given some flexibility in determining whether a refinance transaction is reportable
- The new rule defines the term "refinancing" as
  - A new obligation that satisfies and replaces an existing obligation by the same borrower, and
  - *Both the existing and the new loan are secured by liens on dwellings*

Refinance - §203.2(k)
(Continued)

- No purpose test
  – Results in the reporting of certain refinancings of commercial loans (e.g., those in which the home of the borrower is used as collateral)

- Lender may rely on borrowers statement about whether the loan being refinanced is dwelling secured

- MECAs (modification, extension, and consolidation agreements) continue to be reported

Home Improvement - §203.2(g)

A loan secured by a lien on a dwelling that is for the purpose (in whole or in part) of repairing, rehabilitating, remodeling, or improving a dwelling or the real property on which it is located ***regardless of how that loan is classified by the financial institution***

OR

A non-dwelling secured loan for the purpose (in whole or in part) of repairing, rehabilitating, remodeling, or improving a dwelling on the real property on which it is located, and that is classified by the financial institution as a home improvement loan

Home Equity Lines of Credit (HELOCs) - §203.2(f)

- Definition corresponds with Regulation Z
- Reporting remains optional
- May be for home purchase or home improvement purpose
- Report only amount of line used for HMDA purpose (i.e., home purchase or home improvement portion

Multiple Purpose Loans

- Home purchase trumps home improvement and refinancings
- Home improvement trumps refinancings
- HELOC trumps all, but reporting remains optional

Ethnicity and Race - §203.4 (b)

- Applicants are asked to report race ***and*** ethnicity
  - To be reported in accordance with the standards set by the U.S. Office of Management and Budget in 1997
- Applicants will be given the option to select multiple race categories.
- No more "other" category

- ***Reminder*** - Beginning January 1, 2003 lenders required to request government monitoring information for any application taken by telephone

Ethnicity and Race - §203.4 (b)
(Continued)

- Must request information on ***all*** applications
  – Mail, telephone, Internet
- If applicant declines to provide, collect based on visual observation ***except*** for mail, telephone or Internet
  – Continue to use “not available” codes

Ethnicity and Race - §203.4 (b)
(Continued)

- OMB website has definitions of race and ethnicity designations
- Race designations
  - American Indian or Alaska Native
  - Asian
  - Black or African American
  - Native Hawaiian or Other Pacific Islander
  - White
- Ethnicity designations
  - Hispanic or Latino
  - Not Hispanic or Latino

Rate Spread - §203.4(a)(12)

Pricing data must be reported if the rate spread between the annual percentage rate (APR) on a loan and the yield on comparable Treasury securities equals or exceeds 3% for first lien and 5% for subordinate lien loans

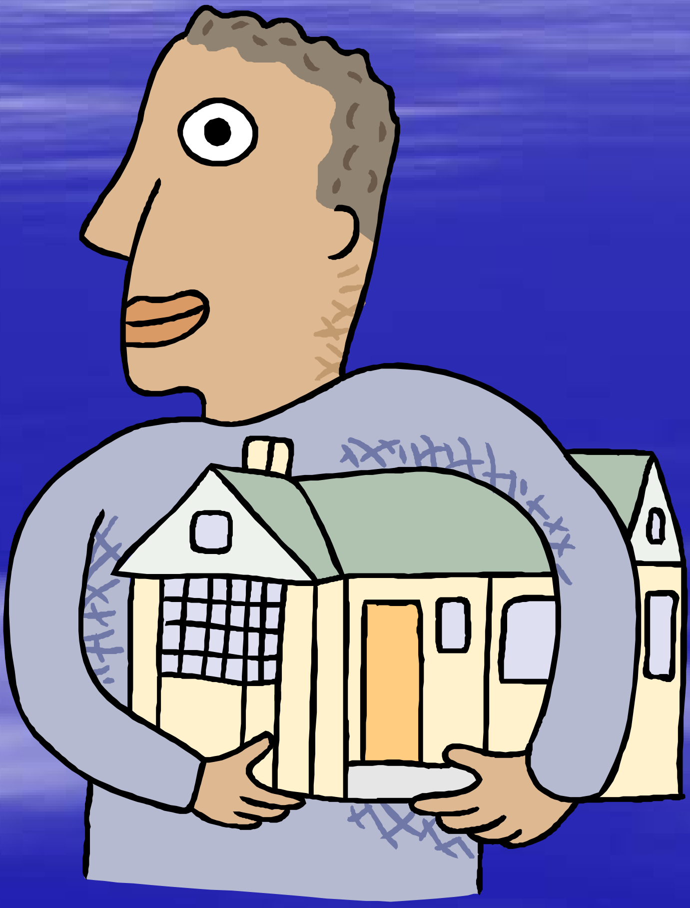
Rate Spread - Lock Date

- Use date rate was locked for final time
  - Agreement
  - Float down
  - Last lock before closing
- Use 15th of month before the date the rate was locked

Rate Spread - Calculate and Report

- To calculate the rate spread, use Board's calculator on FFIEC website - (www.ffiec.gov/ratespread)
- Use only whole numbers for loan term
- ARMs – use loan term, not rate period
- Do not report rate spread for:
  - Purchased loans
  - Unsecured home improvement loans

HOEPA Status - §203.4(a)(13)



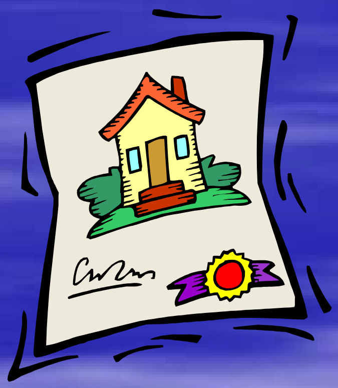
- Lenders to report whether a loan is covered by the Home Ownership and Equity Protection Act (HOEPA)
- HOEPA loans are high rate, high yield loans secured by a consumer's principal dwelling that are <u>not</u> residential mortgage transactions (i.e. <u>not</u> transactions made to purchase or construct the dwelling)

HOEPA Status - §203.4 (a)(13)
(Continued)

- Report only for originations and purchased loans
- Report only for loans subject to Regulation Z
- Check rates on the H.15
  - Use the rate on the 15^{th} of the month before the month in which the application is received
  - Applications received on any date in April 2004 would all use the March 15, 2004 Treasury Security rates

Lien Position - §203.4(a)(14)

- Lenders required to report lien status of originated loans
  - Report as first lien, subordinate lien or unsecured
- Requirement goes hand-in-hand with the reporting of loan pricing
- Facilitates interpretation of the pricing data



Transition Rules

- Pre-approvals and manufactured housing
  - Lenders need not report whether or not an application taken in 2003 but with final action in 2004 involved a request for a pre-approval or a manufactured house
- Definitions of refinancing and home improvement
  - Lender may – at their option – apply the current definitions to applications taken in 2003 with final action taken in 2004
- Rate Spread
  - Lenders are not required to report the rate spread for loans where the rate lock date is prior to January 1, 2004

No Transition Rules

- HOEPA Status
- Lien Status
- Purchaser Type
- Race and Ethnicity
  - Lenders must convert old to new

Conversion Rules – Race & Ethnicity

Current Categories	New Categories Race	New Categories Ethnicity
Code 1 – American Indian or Alaskan Native	Code 1 – American Indian or Alaskan Native	Code 4 – Not Applicable
Code 2 – Asian or Pacific Islander	Code 2 -- Asian	Code 4 – Not Applicable
Code 3 – Black	Code 3 – Black or African American	Code 4 – Not Applicable
Code 4 – Hispanic	Code 7 – Not Applicable	Code 1 – Hispanic or Latino
Code 5 – White	Code 5 – White	Code 4 – Not Applicable
Code 6 – Other	Code 7 – Not Applicable	Code 4 – Not Applicable
Code 7 – Mail or Telephone	Code 6 – Mail, Internet, or Telephone	Code 3 –Mail, Internet, or Telephone
Code 8 – Not Applicable	Code 7 – NA	Code 4 – NA

Most Challenging Areas

- To date, lenders indicate the most challenging changes to implement are:
  - – Pricing information – rate spread and HOEPA status
  - – Revised definition of refinancing
  - – Preapprovals
  - – Race / ethnicity transition rules

Resources Available

- St. Louis FRB HMDA Amendments website: http://www.stlouisfed.org/hmdaregcamendments/default.html
- FAQs attached

Are You On Track?

New reporting requirements went into effect on January 1, 2004

Public Welfare Investments & the CRA Investment Test

Public Welfare Investments

- As public welfare investments become increasingly more common in CRA investment test strategies, banks are reminded that agency rules provide limits to public welfare investments as well as notification and prior approval requirements.
  - FDIC – 12 CFR Part 362
  - FRB – Regulation H, 12 CFR 208.22
  - OCC & OTS – 12 CFR 24

Public Welfare Investment Limits

- The aggregate of all of a bank’s public welfare investments cannot exceed the sum of ***five*** percent of capital stock and surplus. If a bank wishes to make investments exceeding these limits it must submit an application for approval. In no case, however, may a bank’s aggregate public welfare investments exceed ***10*** percent of capital stock and surplus.

- Different rules apply for bank holding companies and financial holding companies
  - Refer to Regulation Y, 12 CFR 225.

Notification Requirements

- Not more than 30 days after entering into a binding legal commitment to fund a public welfare investment, a bank shall advise its regulator of the investment, including the amount of the investment and the identity of the entity in which the investment is made.

Prior Approval Requirements

- Prior approval is required unless all of the following conditions are met:
  - The investment is in a qualified entity.
  - The investment is permitted by state law.
  - The investment will not expose the bank to liability beyond the amount of the investments.
  - The aggregate of all such investments of the member bank does not exceed the sum of five percent of its capital stock and surplus.
  - The bank is well capitalized or adequately capitalized.
  - The bank received a composite CAMELS rating of 1 or 2 as of its most recent examination and an overall rating of 1 or 2 as of its most recent consumer compliance examination.
  - The bank is not subject to any written agreement, cease-and-desist order, capital directive, prompt-corrective-action directive, or memorandum of understanding.

Qualified Entities

- A corporation, limited partnership, or other entity that engages solely in qualified community development activities. These include entities that:
  - Invest in, develop, rehabilitate, manage, sell, or rent residential property where the majority of the units will be occupied by low- and moderate-income persons; or
  - Invest in, develop, rehabilitate, manage, sell, or rent nonresidential property located in a low- or moderate-income area that is targeted toward low-and moderate-income persons; or
  - Invest in one or more small businesses located in a low- or moderate-income area to stimulate economic development; or
  - Invest in, develop or otherwise assist job training or placement facilities or programs that will be targeted towards low- and moderate-income persons; or
  - Invest in an entity located in a low- or moderate-income area if the entity creates long-term employment opportunities, a majority of which will be held by low- and moderate-income persons; or
  - Provide technical assistance, credit counseling, research, and program development assistance to low- and moderate-income persons, small businesses, or nonprofit corporations to help achieve community development.

- Qualified entities also include:
  - A particular CDC, CDFI or limited partnership, or a class of CDCs, CDFIs or limited partnerships, for which the Board has previously approved state member bank or bank holding company public welfare investments; and
  - Any specific CDC, CDFI, limited partnership, or other entity that the OCC has previously approved as a qualified community development investment.

Resources Available

- The Board of Governors guidance for community development and public welfare investments provides detailed information that can assist banks in complying with Regulation H.
  - *Community Development Investments* - http://www.federalreserve.gov/CommunityAffairs/cdi/default.htm

- The FDIC has published a guide that includes guidance on how to structure other investments to achieve a community development purpose.
  - *Community Development Investment Guide* - http://www.fdic.gov/consumers/community/investmentguide.html

- Both the Board and the OCC have published directories of community development investments that can be used to determine if an organization is a qualified entity.
  - *2002 Directory of Community Development Investments for Bank Holding Companies and State Member Banks* - http://www.federalreserve.gov/dcca/directory/cdi02.pdf
  - *2002 Directory of National Bank Community Development Investments* - *http://www.occ.treas.gov/cdd/2002Part24Dir.pdf*

CRA Investment Test

- Banks should be mindful of these limits when managing the CRA investment portfolio
- Ensure notification and approval rules are followed
- Consider limits in performance context as appropriate

Proposed Changes to the CRA Regulation

Proposed Changes to the CRA Regulation

- Proposed Rule published on February 6, 2003

- Proposal developed after review of 400 comment letters in response to July 2001 *Advance Notice of Proposed Rulemaking*

- Comment period closed April 6, 2004

Proposed Changes to the CRA Regulation

- Small Bank Definition
  - Amends definition to mean institutions with total assets of less than $500 million without regard to holding company assets
    - Considers asset growth and industry consolidation since 1995
    - Eliminates holding company test
- Predatory Lending and Abusive Practices in the CRA Evaluation
  - Abusive lending practices inconsistent with CRA and other national objectives
  - Evidence that any institution or any affiliate with loans considered in the CRA evaluation engaging in certain specified discriminatory, illegal or abusive practices will adversely affect the institution's CRA evaluation.

Proposed Changes to the CRA Regulation

- Other issues raised by commenters should be handled through enhanced examiner guidance.

Proposed Changes to the CRA Regulation

Comment letters suggest:

- Bankers support raising the asset threshold even higher

-Bankers feel fair lending examinations provide adequate controls to curb abusive lending

Proposed Changes to the CRA Regulation

Comment Letters Suggest Community Groups:

-Do not support raising the asset threshold

-Believe the abusive lending proposal does not go far enough

-Are disappointed agencies made no changes to treatment of affiliates of delineation of assessment areas


THANK YOU