Required Compliance for Commercial Loans Secured by Real Estate

Handout

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For Financial Institutions
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INSTRUCTOR

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Susan has successfully managed compliance programs and exams for institutions that ranged from a community bank to large multi-state bank holding companies. She has been a compliance officer for institutions supervised by the OCC, FDIC, and Federal Reserve. Susan has been a Certified Regulatory Compliance Manager since 1998, completed the ABA Graduate Compliance School, and graduated from the University of Akron and the Graduate Banking School of the University of Colorado. She regularly presents to financial institution audiences in several states and “translates” complex regulations into simple concepts by using humor and real life examples.

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SEMINAR OBJECTIVES
Which regulations apply to commercial loans that are secured by real estate? Are there any exceptions when the real estate is taken as “an abundance of caution”? Do the commercial lenders and support staff at your bank understand the data collection required for HMDA reportable applications? Is a written application required for a business-purpose loan? Join this fast-paced webinar to understand the application process with step-by-step instructions and actual examples that explain the regulatory requirements in terms that are easy to understand.

HIGHLIGHTS
- Which factors determine if the application is for business or consumer purpose?
- What are the compliance requirements and common violations when real estate is taken as collateral?
- Review of the required disclosure for the “Right to Receive a Copy of Appraisal”
  - Who receives the notice and what are the timing rules?
  - This does apply to first-lien loans regardless of purpose – there is no “business-purpose” exception
- Overview of HMDA requirements and preview of the changes to business-purpose loans when the new HMDA rules become effective January 1, 2018.
- Flood insurance violations can be costly. What are some of the unique challenges with commercial buildings and collateral?
- There are four “trip wire” events for flood insurance. Learn about the new rules for “detached structure on residential property”.

TAKE-AWAY TOOLKIT
- Matrix of 28 loan types and required disclosures for both consumer and commercial loans with explanations about real-estate-secured loans
- Checklists that outline which compliance regulations apply to commercial credit and the exemptions
- Step-by-step HMDA controls
- Flood insurance resources
- Collateral checklist
- Fair lending policy – business-purpose loan requests are covered by the Equal Credit Opportunity Act and the Fair Housing Act
- Quiz you can administer to measure staff learning and a separate answer key
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<th></th>
<th>Consumer</th>
<th>Business</th>
<th>Commercial Requirements</th>
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| Reg B                          | ✓        | ✓        | • Evidence of intent to borrow jointly must be documented if there is more than one applicant  
• Adverse action – oral notice is permitted, but reasons must be provided if requested  
• All ECOA requirements apply for non-discriminatory treatment and fair lending  
• Appraisal/Valuation notice & copy required – **NEW**, first liens only |
| Reg C HMDA                     | ✓        | ✓        | • Purchase*  
• Home Improvement (can include improvements to apartment complex, for example)  
• Refinance*  
• Monitoring Information  
• Annual LAR Data Submission  
• Public Disclosures  
*dwelling secured |
| Reg Z                          | ✓        | ×        | • Make sure to clearly document purpose to prove that the exemption from Reg Z applies |
| RESPA                          | ✓        | ×        | • Make sure to clearly document purpose to prove that the exemption from RESPA applies  
• Reg Z determines exemption |
| BSA CIP                        | ✓        | ✓        | • The true identity of the borrower must be verified and appropriate documentation must be retained  
• Legal purpose of loan; “clean” payments  
• Due diligence on account activity |
| Loans to Insiders              | ✓        | ✓        | • Insiders include officers, directors, employees and members of their immediate family. |
| Flood                          | ✓        | ✓        | • Standard Flood Hazard Determination Form  
• Notice of Flood Status  
• Coverage Calculation & Proof of Insurance  
• Forced Placement Notification |
COMMERICAL LENDING HOTSPOTS

Remember the days when we all called it "consumer compliance"? Compliance now reaches throughout the bank. Compliance examiners are looking at more commercial loan files - something that they generally haven't done in the past. The Financial Crimes Enforcement Network (FinCEN) fined J.P. Morgan Chase Bank, N.A. $461 million in January, 2014, for willfully violating the Bank Secrecy Act (BSA) by failing to report suspicious transactions arising out of Bernard L. Madoff’s decades-long, multi-billion dollar fraudulent investment scheme. Compliance risk is now at an all time high in the commercial lending department.

Fair Housing
The Fair Housing Act can affect commercial lending in two ways. First, it prohibits discrimination in any aspect of housing. This includes not only mortgages on single family homes, but also loans for acquisition or construction of any kind of dwelling, including apartment buildings and housing developments. Commercial lenders need to be aware that discrimination is prohibited based on the borrower, associates of the borrower (purchasers or employees) and the location of the property. In addition, it may be prudent to take some steps to ensure that their commercial borrowers do not discriminate. It is not clear yet whether the lender would be held liable for knowingly making or renewing a loan on a building where the management is known to treat residents differently based on race.

ECOA – Regulation B
Contrary to popular commercial lender lore, the Equal Credit Opportunity Act and Regulation B apply to commercial loans. There is no consumer purpose test in this part of the Consumer Credit Protection Act. So unlike Regulation Z, Regulation B doesn't worry about whether the application is for personal or business credit. The only way that commercial loans are given any special treatment is in the slightly streamlined adverse action notification procedures of 1002.9. A new requirement for appraisal/valuation notices and providing copies of the appraisal to an applicant if there is a FIRST LIEN security interest on a 1-4 family dwelling became effective January 18, 2014. This will give examiners yet another reason to review commercial files. The bottom line is that ECOA prohibits discrimination in business lending just as it does in consumer lending.

Flood Hazard
Flood insurance regulations are based on whether the lender takes a security interest in improved real property. The act and regulations do not distinguish between commercial and consumer borrowers. All of the certification and timing requirements apply to commercial loans. Any improvements - and that includes warehouses and barns - located in a flood hazard area must be covered by flood insurance before the loan is closed. Although commercial lenders may believe that a commercial borrower is sufficiently knowledgeable to decide whether to take the risk of not purchasing flood insurance, Congress didn't think so. Congress wanted those loans insured because it is tired of bailing out the uninsured after the flood. When business customers resist purchasing insurance, it may be useful to remind them that disaster assistance is a loan, not a grant, and it is only available once. Many examiners have aggressively enforced these rules and often taken a ZERO tolerance position for failure to complete a determination, notify the borrower for any triggering event*, have proof of ADEQUATE coverage at loan closing, and maintain coverage for the life of the loan which may require the bank to force place a flood policy.
• *NOTE – Remember MIRE to help remember the four “trip wire” events that require a bank to provide a notice to a customer when a security interest is taken in a building located in a Special Flood Hazard Zone are the following:
  1. When the bank “makes” the loan
  2. When the bank “increases” the loan
  3. When the bank “renews” the loan
  4. When the bank extends the loan

FCRA
Fair Credit Reporting is a consumer protection law. However, there are certain situations when it may apply in business loans. The act broadly covers all reports compiled, obtained, and used about consumers. A report on the history and economic condition of a corporation would not be covered by FCRA. However, if the lender also obtains “credit reports” on the owner or principals of the business, these reports are subject to FCRA. The commercial lender obtaining and using credit reports on individuals must comply with the FCRA requirements for obtaining reports and providing notices in the event of adverse action based on information in the reports. There are additional FCRA notice requirements for credit score disclosures and for responding to inquiries about the accuracy of information reported to a credit reporting agency.

Last but not least… “Accommodation Loans” are still Consumer Loans
Commercial lenders may be asked to make accommodation loans to their business customers. The loan may be home equity, a mortgage, a consumer loan, or other types of loans that are actually consumer loans. Unless the loan is made for a business purpose, these loans are consumer loans and fall squarely within the requirements of all the consumer regulations. The fact that the borrower is a business does not change the coverage of the laws and regulations. These actions bring in the full array of consumer credit protection regulations, including Regulation Z, RESPA, and the stricter notice provisions of Regulation B.

HMDA, (Regulation C)
The Home Mortgage Disclosure Act requires lenders to report information on certain types of loans, by amount, location, and borrower identity. Reportable loans include requests for purchase, improvement and refinancing. This can be particularly problematic in the commercial area. EXAMPLE: Last year Joe Lumber Yard borrowed money to start a business. Jim Lender took the lumber business (building & inventory) as collateral and Joe’s house, as “an abundance of caution” and made a loan with a one year maturity. Last year the bank’s assets increased to $44 million and they are located in an MSA; so 2016 will be the first year to report HMDA data. Joe’s business does well and the loan has matured. Jim reviews the information and decides to refinance the loan for an additional year on the same terms and collateral. This “refinance” transaction includes a security interest in a dwelling and the original (NON HMDA REPORTABLE LOAN) had a security interest in a dwelling; this loan is NOW reportable as a refinance under HMDA. Reporting includes loans on multifamily dwellings. Commercial loans to purchase, improve or refinance multi-family buildings or developments are HMDA-reportable.
**Loans to Insiders**

Insiders include officers, directors, committee members, employees and members of their immediate families. These loans must comply with Regulation O provisions (Loans by Member Banks to their Executive Officers, Directors and Principal Shareholders). Examiners will take these steps to check for compliance:

- Trace loan to officials back to the approval in board minutes
- Ensure that the rules have been followed regarding preferential treatment
- Review statements for negative balance activity, consistent application of fees and charges, and numerous or unusual transactions.
WHAT SHOULD COMMERCIAL LENDERS KNOW ABOUT COMPLIANCE RULES?

✓ It always begins with **documentation**. Since many banks do not have a formal business application it’s important to collect or document these key factors:

<table>
<thead>
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<td>Amount of request</td>
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<tr>
<td>Terms of request and loan type (secured, unsecured, line of credit, term of loan)</td>
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<td>Collateral offered</td>
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<td><strong>Ownership of collateral</strong></td>
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<td>Location of collateral</td>
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<td>Borrower information (sole proprietor, partnership, corporation, joint intent). Follow your CIP procedures</td>
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<td>Guarantors -</td>
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✓ BONUS – See the SAMPLE BUSINESS LOAN APPLICATION IN THE Take-Away Tool Supplement

✓ This format is a good start to collect basic information; it is from the website of a large bank

**Collect the Business Information Listed Below**

**Business Information**
- Business name
- Business address (no P.O. Box)
- Business phone number
- Business fax number
- Tax Identification Number/SSN
- Date your business was established
- Ownership type
- # of owners
- Annual revenue
- Business deposit account number(s) and balance(s)

**Business Owner Information**
- Name
- Home address
- Home phone number
- Social Security Number(s)
- Citizenship
- Annual household income
- Personal account number(s) and balance(s)

**Contact Information**
- Primary contact (must be an owner of the business)
- Primary contact phone number
- Primary contact email address
✓ Commercial lenders must have a working knowledge of Reg B requirements, including the signature guarantee rules (and prohibitions.). The appraisal requirements on first lien real estate secured applications are relatively NEW and should be monitored closely.

 ✓ If commercial lenders obtain credit reports on individuals involved with the businesses the FCRA requirements must be followed. Credit score disclosures must be provided.

 ✓ Commercial lenders must know rules about loans with various dwellings, including development loans and multiple dwelling buildings. Fair lending issues must be understood. The matrix in the SUPPLEMENT can be a helpful tool.

 ✓ Commercial loan files must be audited for compliance with flood hazard requirements. Lenders should follow the correct procedures for flood insurance compliance.

 ✓ The HMDA-LAR must be reviewed to see whether reportable commercial loans are properly entered. While the monitoring information for a corporation or partnership is “NA”, many examiners expect that a sole proprietor is asked for ethnicity, race and gender if the application is taken in person; it should be requested in a phone application and the response is noted in the loan file.

 ✓ Commercial lenders must understand insider lending restrictions. Commercial lenders should be involved in the process of maintaining the insider lists. No-one knows organizational structure better than a commercial lender.

 ✓ Compliance training should be focused with the most emphasis on identifying consumer purpose loans that are subject to Regulation Z, especially the new INTEGRATED DISCLOSURE requirements. It may help to develop a buddy system so that a commercial lender can get compliance support from an experienced consumer lender.
LENDING REGULATION HIGHLIGHTS

The following are brief summaries of key regulations for the lending area of your financial institution.

Equal Credit Opportunity Act
Regulation B, under the Equal Credit Opportunity Act (ECOA) prohibits lenders, including commercial lenders, from discriminating against credit applicants, establishes guidelines for gathering and evaluating credit information, and requires written notification when credit is denied.

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<td>Religion</td>
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<td>National origin</td>
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<td>Sex</td>
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<td>Marital status</td>
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<td>Age</td>
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<tr>
<td>Receipt of public assistance income</td>
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<tr>
<td>Exercising, in good faith, any right under the Consumer Credit Protection Act</td>
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Fair Housing Act
The Fair Housing Act, 42 U.S.C. 3601 et seq., prohibits discrimination by direct providers of housing, such as landlords and real estate companies as well as other entities, such as municipalities, banks, credit unions, or other lending institutions and homeowners insurance companies whose discriminatory practices make housing unavailable to persons based on seven prohibited bases.
BSA
The Bank Secrecy Act requires that financial institutions assist the government in the prevention of money laundering. The FFIEC exam manual says that all depository institutions must have a compliance program that “at a minimum” “provide training for appropriate personnel.” A lender must know if the applicant is seeking funds for a legal purpose. The Patriot Act requires that the true identity of the borrower, whether it is a sole proprietor, partnership, or corporation be verified. These CIP (Customer Information Program) procedures are required to determine the true identity an individual or business that opens deposit accounts or loans. All MSB’s must be registered with FinCEN and have required state registrations. There are additional requirements under OFAC for opening accounts and monitoring account activity.

Flood Hazard
Flood insurance regulations are based on whether the lender takes a security interest in improved real property. The act and regulations do not differentiate between commercial and consumer borrowers. Any walled and roofed structures (which often include warehouses and barns) – that are located in a flood hazard area must be covered by flood insurance before the loan is closed.

HMDA
The Home Mortgage Disclosure Act requires lenders to report information on certain types of loans, by amount, location, and borrower identity. Reporting includes loans on multifamily dwellings. Commercial loans on multi-family buildings or developments are HMDA-reportable. Examiners are looking closely at HMDA activity at financial institutions during fair lending exams. Commercial loans are NOT exempt from this reporting requirement.

RESPA
The Real Estate Settlement Procedures Act (Regulation X) governs many aspects of mortgage loan disclosures. This regulation also established the framework for escrow account requirements and servicing of mortgage loans. The CFPB has implemented significant changes to comply with the Dodd-Frank mandate that combined Truth in Lending and RESPA disclosures into a new “LOAN ESTIMATE” and “CLOSING DISCLOSURE” under Truth in Lending rules. Business purpose loans are EXEMPT from this regulation, and relies on the definition of business purpose in Regulation Z.

Truth in Lending (Regulation Z)
Reg Z applies only to credit offered, applied for, or extended to an individual for a consumer purpose and is subject to a finance charge and is payable in more than four installments in a written agreement. This regulation requires creditors to make disclosures to consumers about the costs of borrowing and other aspects of consumer credit transactions. There is an annual adjustment to Reg Z coverage for loans that are not secured by real estate. That limit remains the same as the 2015 threshold of $54,600 for 2016.
CONSUMER CREDIT DEFINITION

Business purpose requests are exempt from RESPA and Reg Z compliance. It’s important to understand the following definitions and clearly document the loan file to indicate if application is subject to consumer purpose laws or if it is a business purpose loan.

Business purpose requests are further defined in the Official Staff Interpretations to Regulation Z as follows:

Section 1026.3 - Exempt Transactions

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:

   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.

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.

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)–4, 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:

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

• 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)–2.
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 a land trust 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.**

*(NOTE: This was a change with Integrated Disclosure that became effective October 3, 2015)*

**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

**b. Credit over applicable threshold amount.**

**(1) Exemption.**

**(i) Requirements.** An extension of credit in which the amount of credit extended exceeds the applicable threshold amount or in which there is an express written commitment to extend credit in excess of the applicable threshold amount, unless the extension of credit is:

(A) Secured by any real property, or by personal property used or expected to be used as the principal dwelling of the consumer; or

(B) A private education loan as defined in § 1026.46(b)(5).

*NOTE: From January 1, 2016 through December 31, 2016, the threshold amount is $54,600.*
WILL I QUALIFY FOR A LOAN?

Regulation B defines application at a point earlier than any other regulation. For purposes of Regulation B, an application exists when an applicant first asks about credit from the lender. The purpose of Regulation B’s definition is to extend the regulation’s protections to individuals at the earliest possible phase of applications because the opportunity to discriminate exists.

WHAT IS THE ROLE OF THE COMMERCIAL LENDER IN FAIR LENDING?

You represent the financial institution. A loan applicant or a “tester” from the Department of Justice can ask a commercial lender or any employee of the bank this question:

“Do you think I’ll qualify for a loan? I’ve got a GREAT idea for a new business. I’m sure it won’t fail like the last three business that closed before the first year of operation. I’ve made most of the payments on the IRS tax liens. It wasn’t my choice, but I my attorney advised me to declare bankruptcy last year. What do you think my chances are for being approved? Should I even bother to apply?

IF YOU ANSWER THIS QUESTION WITH ANY RESPONSE ABOUT THE CUSTOMER’S CHANCES FOR APPROVAL YOU MAY HAVE ACCEPTED AN “ORAL APPLICATION”. AN ORAL APPLICATION CAN OCCUR IF YOU HAVE GIVEN THE CUSTOMER AN OPINION ABOUT WHETHER OR NOT THEIR LOAN REQUEST WILL BE APPROVED. ANY NEGATIVE COMMENTS MAY BE CONSIDERED “DISCOURAGING” AN APPLICANT.

IMPORTANT REMINDERS

1. Don’t go there! The standard response to this question should ALWAYS be “I’d be glad to give you a loan application or arrange for you to speak to someone in the lending area. A loan application is required for the bank to fully evaluate all the factors involved in making a credit decision.”

2. If the customer continues to pressure you about loan qualifications, be polite and explain that someone from the lending area would be able to explain the general requirements for the bank’s credit criteria for that particular type of loan. Always thank them for the inquiry and make sure that they are being helped.

3. Treat ALL potential loan applicants in the same courteous manner and never discourage an applicant from completing a loan application. Treating people “the same” includes things like:
   a. Greeting them with a smile, handshake, offering them a seat in the waiting area.
   b. Offering them the business card of a loan officer if that person is not available
   c. Making sure that all customers receive prompt attention and no one has an extended to wait for assistance.
WHAT IS AN APPLICATION?

Bureau of Consumer Financial Protection 12 CFR Chapter X  Part 1002 — Equal Credit Opportunity Act (Regulation B) § 1002.2 Definitions.

(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.

FROM THE 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 “pre-approve” 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.

**TRANSLATION IN ENGLISH:** If a customer tells you about their credit history and asks about their chances for loan approval and you give them an answer…YOU HAVE ACCEPTED AN ORAL APPLICATION
WHAT’S A COMPLETED APPLICATION?

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*.

**What are “procedures”?** This is from the commentary to Reg B 1002.2 9(f). *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. What does this mean in plain English? It means that an informal inquiry, whether it’s all verbal or in writing, will be treated as an application and is subject to Regulation B requirements.

**What is application information versus verifying the information?**

Generally, the information is verified AFTER the application is received. Typically it involves:

1. Tax returns for the business, audited financial statements, cash flow analysis, business plans, corporate resolution to borrow, partnership agreements.
2. Credit report on principals, or Dunn & Brandstreet report.
3. Appraisals, property inspections, equipment or inventory valuations.

**What are the due diligence requirements?** Commentary to Reg B 1002.2 9(f)6. 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*.

**What are some potential changes to the commercial loan application process because of the Dodd-Frank Financial Reform Act?**

The Equal Credit Opportunity Act (ECOA) and Regulation B have long required lenders (yes, even commercial lenders) to understand when they have received an application for credit so they can provide the Regulation B required notices (such as adverse action notices or incomplete application notices). It is also critical for Regulation B purposes to understand when a received application is complete in order to comply with the timing requirements to provide such notices.
The Dodd-Frank Act increases the compliance stakes in the commercial application process through new data collection requirements. **Section 1071 of the Dodd-Frank Act will amend the ECOA or a new regulations and require lenders to collect additional data at the time an application is submitted when the applicant is a small business, or a minority-owned or women-owned business.** This change is often referred to as the new “small business data collection” requirements, and the 14 data points specified in Section 1071 are similar, but not identical, to data collected for HMDA and CRA reporting. This data must be maintained and ultimately reported to the CFPB annually and others upon request. The CFPB has delayed proposing rules for in Section 1071 and hasn’t included this project in their current regulatory agenda. However, when it is implemented these rules will be critical for defining what kinds of commercial loan applicants are small businesses or minority-owned or women-owned businesses, and how lenders are to go about the process of collecting, maintaining and reporting the data. These new requirements will not only impact the data collected by a lender when an application is taken, but also will drive new application time processes and call for new controls related to data access, storage and reporting.

**When the CFPB does make a proposal will your documentation be sufficient to help you comply with the new regulations?** A few key questions that you should ask:

1. What constitutes a credit application according to your institution’s policies?
2. When is a credit application ‘complete’ according to your institution’s policies and practices?
3. What are your compliance obligations in light of those policies and practices?

When doing this review, it is important not only to consider what your policies are, but also to evaluate your practices, i.e., **what really happens within the institution.** For example, your policy may state that a commercial application must be in writing on a specific application form. However, if your practice is to allow customers to request a loan by simply calling a loan officer, then when it comes to regulatory requirements, you must treat these applications the same way you would if they had been submitted in writing – which may be less than ideal in light of the new ECOA data collection requirements.

Clearly defining what information is necessary to have a completed commercial loan application will also be very important. The information collected on the back of that napkin or sticky note won’t work. Since these new ECOA data collection requirements are specific to a subset of applicants, knowing when to collect data and, more importantly, when not to collect data should be identified in the application process. Those institutions that have processes and systems that support consistent, disciplined entry of commercial application data will be better positioned to capture, maintain and report the necessary data to the CFPB and others.
IS IT AN INQUIRY OR AN APPLICATION?

It’s important to understand that a lender can turn an oral inquiry into an application which may trigger the notice requirements for adverse action and disclosures under other regulations. It doesn’t matter if your bank has a “policy” to only accept written applications if the “practice” does something else. Here’s the information about an inquiry:

Commentary 1002.(f)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 [adverse action] 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.

What happens now?

If a lender has disqualified an potential applicant verbally, even if it was a valid underwriting concern, the lender has treated the inquiry as an application. A lender can do this, but is now obligated to follow both the notification and recordkeeping requirements of Regulation B. However these notification and recordkeeping rules apply only to applications and not to inquiries.

REPEAT WARNING: Don’t turn an inquiry into an application. Encourage the customer (or prospective customer) to apply so that the bank can “evaluate fully all their credit qualifications”. If enough information has been collected to make a decision and a denial or approval has been indicated to the applicant, this exchange between the lender and applicant is an “application” according to of Regulation B. Remember the purpose of Regulation B is to promote the availability of credit and explain the terms to potential applicants.

It doesn’t matter if the amount of information collected by the lender is complete according to the application procedures, if no fees have been paid, if the applicant had identified a specific property or loan amount, or whether the exchange is written or verbal.
WHEN IS A WRITTEN APPLICATION REQUIRED?

QUESTION: When does an application have to be in writing?
ANSWER: A consumer purpose loan request to purchase a principal dwelling or refinance the purchase of the principal dwelling required that the lender must take a written application and gather “monitoring” information under 1002.13 of Regulation B.

1. Requirement for written applications. Model application forms are provided in Appendix B to the regulation, although use of a printed form is not required. A creditor will satisfy the requirement by writing down the information that it normally considers in making a credit decision. The creditor may complete an application on behalf of an applicant and need not require the applicant to sign the application.

QUESTION: When must an application be signed?
ANSWER: Commentary 1002.4 Paragraph 4(c)

1. Requirement for written applications. Model application forms are provided in Appendix B to the regulation, although use of a printed form is not required. A creditor will satisfy the requirement by writing down the information that it normally considers in making a credit decision. The creditor may complete an application on behalf of an applicant and need not require the applicant to sign the application (NOTE This is for a consumer-purpose purchase or refinance of purchase money of a principal dwelling, NOT for a typical commercial loan request).

REAL WORLD ANSWER: If your bank’s loan policy requires a written and signed application for a commercial credit request, the policy should be consistently followed.

If the bank enters into litigation with a commercial borrower it may be extremely beneficial to have written and signed documentation in a court case.

REMINDER – Section 1071 of the Dodd Frank Act for Small Business application information has not yet been proposed by the CFPB. However, when/if this requirement becomes final there will be additional rules for data collection on small business loan applications for female and minority owned business applications.
WHAT’S AN APPLICATION UNDER HMDA?

A bank that had assets of $44 million as of 12/31/15 and has an office in an MSA is subject to HMDA reporting for 2016.

Application. - (1) In general. Application means an oral or written request for a home purchase loan, a home improvement loan, or a refinancing that is made in accordance with procedures used by a bank for the type of credit requested.

Section 1003.2—Definitions Home purchase loan.

1. Multiple properties. A home purchase loan includes a loan secured by one dwelling and used to purchase another dwelling.

2. Mixed-use property. A dwelling-secured loan to purchase property used primarily for residential purposes (for example, an apartment building containing a convenience store) is a home purchase loan. An institution may use any reasonable standard to determine the primary use of the property, such as by square footage or by the income generated. An institution may select the standard to apply on a case-by-case basis.

3. Farm loan. A loan to purchase property used primarily for agricultural purposes is not a home purchase loan even if the property includes a dwelling. An institution may use any reasonable standard to determine the primary use of the property, such as by reference to the exemption from Regulation X (Real Estate Settlement Procedures, 12 CFR 1024.5(b)(1)) for a loan on property of 25 acres or more. An institution may select the standard to apply on a case-by-case basis. (CAREFUL – this exemption applies to a PURCHASE; it does not apply to a request for improve or refinance a dwelling on a farm).

4. Commercial and other loans. A home purchase loan may include a loan originated outside an institution's residential mortgage lending division (such as a loan for the purchase of an apartment building made through the commercial loan department).

5. Construction and permanent financing. A home purchase loan includes both a combined construction/permanent loan and the permanent financing that replaces a construction-only loan. It does not include a construction-only loan, which is considered “temporary financing” under Regulation C and is not reported.

6. Second mortgages that finance the downpayments on first mortgages. If an institution making a first mortgage loan to a home purchaser also makes a second mortgage loan to the same purchaser to finance part or all of the home purchaser's downpayment, the institution reports each loan separately as a home purchase loan.

7. Multiple-category loans. If a loan is a home purchase loan as well as a home improvement loan, or a refinancing, an institution reports the loan as a home purchase loan.
WHAT’S AN APPLICATION UNDER RESPA AND TRUTH IN LENDING?

Beginning January 1, 2010 this definition applies for an application under RESPA, the Real Estate Settlement Procedures Act. This is found in Part 1024 of 12 CFR Chapter X; these rules CHANGED significantly on October 3, 2015 when the “integrated disclosure” rules become effective.

Application means the submission of a borrower's financial information in anticipation of a credit decision relating to a federally related mortgage loan, which shall include

1. the borrower's name,
2. the borrower's monthly income,
3. the borrower's Social Security number to obtain a credit report,
4. the property address,
5. an estimate of the value of the property,
6. the mortgage loan amount sought, and
7. any other information deemed necessary by the loan originator was allowed UNTIL October 3, 2015, and was REMOVED under the Integrated Disclosure Rules (Warning – this cannot include verification documentation)

An application may either be in writing or electronically submitted, including a written record of an oral application

§ 1024.5 Coverage of RESPA.
(b) Exemptions. (1)

(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.

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.)

What’s an application under Truth in Lending, Reg Z?

3. Written application. Creditors may rely on RESPA and Regulation X (including any interpretations issued by the Bureau) in deciding whether a “written application” has been received. In general, Regulation X defines “application” to mean the submission of a borrower's financial information in anticipation of a credit decision relating to a federally related mortgage loan.
INTEGRATED DISCLOSURE CHANGES

In theory, a commercial application secured by real estate will be exempt from the complex integrated disclosure rules because it is NOT a consumer purpose loan. However, it’s helpful to be aware of when the rules may be triggered by looking at some of the key coverage definitions.

The basic coverage begins with “real property” (including vacant land) that is closed-end and made for a consumer purpose:
Truth in Lending 1026.19 (e)
(e) Mortgage loans secured by real property—early disclosures.
(1) Provision of disclosures.
(i) Creditor. In a closed-end consumer credit transaction secured by real property, other than a reverse mortgage subject to § 1026.33, the creditor shall provide the consumer with good faith estimates of the disclosures in § 1026.37.

Here is a comparison chart of the “old” and “new” coverage

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<tr>
<th>OLD COVERAGE</th>
<th>NEW - COVERAGE</th>
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<tr>
<td>A consumer loan request, regardless of the purpose, that is secured by a first or subordinate lien on residential real property, including the refinancing of a dwelling secured loan is subject to RESPA. However, there are several exemptions including:</td>
<td>Must be a “creditor” that makes more than five mortgages per calendar year, the coverage is EXPANDED from the current provisions of RESPA (1024.5) and TRUTH IN LENDING (1026.3 and 1026.19) to the provisions in TRUTH IN LENDING found in 1026.37 for the LOAN ESTIMATE and 1026.38 for the CLOSING DISCLOSURE. These are some EXEMPTIONS from coverage:</td>
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<td>✓ Property of more than 25 acres</td>
<td>✓ HELOCs</td>
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<td>✓ Temporary financing</td>
<td>✓ Reverse Mortgages</td>
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<td>✓ Vacant Land</td>
<td>✓ Chattel-dwelling loans, such as secured by a mobile home or a dwelling that is NOT attached to real property (i.e. land)</td>
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<td>✓ Business Purpose</td>
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<td>✓ Loan Modifications</td>
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<td>✓ HELOCs</td>
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In addition to consumer-purpose dwelling secured transactions, certain loans have been subject to TILA but were exempt from RESPA. These loan types have been ADDED to the TILA-RESPA Integrated disclosure requirements:

NEW COVERAGE- IF CLOSED-END & CONSUMER PURPOSE
✓ Construction-only loans
✓ Loans secured by vacant land or by 25 or more acres
✓ Credit extended to certain trust for tax are estate planning are covered
<table>
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<tr>
<th>OLD-Applications taken BEFORE 10/3/2015</th>
<th>NEW- Applications taken on or after 10/3/2015</th>
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<td>Application means the submission of a</td>
<td>(3) (i) Application means the submission of a</td>
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<td>the purpsoes of obtaining an extension</td>
<td>purposes of obtaining an extension of credit.</td>
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<td>of credit</td>
<td>(ii) For transactions subject to § 1026.19(e),</td>
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<td>✓ the consumer's Social Security</td>
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<td>number to obtain a credit report,</td>
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<td>✓ the property address,</td>
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<td>✓ an estimate of the value of the</td>
<td>✓ the property address,</td>
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<td>property,</td>
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<td>✓ the mortgage loan amount sought</td>
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<td>✓ any information deemed necessary by</td>
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<td>the creditor</td>
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Application - The definition of an application has changed slightly to remove the reference to “any other information deemed necessary by the loan originator…”. This means once you have received the applicant’s name, income, social security number, property address, estimated property value, and loan amount, you have an application that triggers these disclosure requirements. It appears the Final Rule allows a financial institution to request and collect additional information, it just can't require it. In other words, you cannot delay providing the disclosures because you want more information than the six items mentioned above. If you have the six items, you have an application.
REGULATION B – EQUAL CREDIT OPPORTUNITY ACT CHART

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<th>Regulation B – Equal Credit Opportunity Act</th>
<th>Fair Lending Concerns</th>
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<tr>
<td>1002.1 Authority, scope and purpose.</td>
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<tr>
<td>1002.2 Definitions.</td>
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<tr>
<td>1002.3 Limited exceptions for certain classes of transactions</td>
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<tr>
<td>1002.4 General rules</td>
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<td>1002.5 Rules concerning requests for information</td>
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<td>1002.6 Rules concerning evaluation of applications.</td>
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<td>1002.7 Rules concerning extensions of credit</td>
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<td>1002.8 Special purpose credit programs</td>
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<td>1002.9 Notifications</td>
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<td>1002.10 Furnishing of credit information</td>
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<tr>
<td>1002.11 Relation to state law</td>
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<tr>
<td>1002.12 Record retention</td>
<td>√</td>
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<tr>
<td>1002.13 Information for monitoring purposes</td>
<td>√</td>
</tr>
<tr>
<td>1002.14 Rules on providing appraisal reports and other valuations</td>
<td>NEW REQUIREMENTS! January 18, 2014</td>
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The purpose of the ECOA is to promote the availability of credit to all creditworthy applicants without regard to any of the prohibited bases.

The regulation does not attempt to dictate standards of creditworthiness. It does, however, try to strike a balance between your need as a lender to know about the applicant and the applicant’s right to privacy regarding questions that have no bearing on his/her creditworthiness.

**Regulation B applies to both consumer and business purpose credit.** The difference is found in adverse action notification requirements. Reg B covers the entire life of the loan as well as marketing practices.
REG B DISCLOSURES

- **Written application required** (A written application is required for an application for credit primarily for the purchase or refinancing of a dwelling occupied or to be occupied by the applicant as a principal residence, where the extension of credit will be secured by the dwelling) 12 CFR 1002.5(e) 12 CFR 1002.13

- **Notice of intent of joint application** A person’s intent to be a joint applicant must be given at the time of application. This requirement became effective 4/15/2004. 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 12 CFR 1002.7(d)(3). There is no exemption for business purpose loans, although this requirement may or may not be cited in compliance exams. There are some options on determining a person’s intent to be a joint applicant (Joint Intent Compliance):
  1. Signed Applications – with both signatures
  2. Signed Applications & Separate Affirmation – applications with the signatures are stronger proof when the form has a separate disclosure where applicants affirm joint intent. This is the best practice.
  3. No written application – provide (at time of application) a joint intent disclosure so they can indicate joint intent
  4. No written application & no applicant acknowledgement – the loan officer may document a note to the credit file; showing a date would be helpful

- **Notice of incompleteness** (or, in the alternative, a notice of action taken) 12 CFR 1002.9(c)

- **Notice of Action Taken**
  12 CFR 1002.9(a)(2) (consumer applicants); 12 CFR 1002.9(a)(3) (business applicants)

- **Statement of reasons for adverse action** or notice of right to obtain a statement of reasons 12 CFR 1002.9(b)

- **Credit score disclosures on adverse action notices** – consumer loans
NEW! Rules on providing appraisals and other valuations –NEW RULES – effective January 18, 2014. (See “Cheat Sheet” in the Take-Away Tool Supplement) Applies any time an appraisal or other valuation report is used in connection with an application for credit that is to be secured by a first lien on a dwelling (dwelling is a residential structure that contains one to four units whether or not that structure is attached to real property), 12 CFR 1002.14.

14(a) From the Commentary: Providing appraisals and other valuations.

1. Coverage. This section covers applications for credit to be secured by a lien on a dwelling, as that term is defined in § 1002.14, 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).

IMPORTANT POINTS – Regulation B now includes new rules for appraisals but there has been no clarification yet regarding some of the terms and definitions. The word “appraisal” isn’t clearly defined, but “valuation” is defined. A valuation includes any document that establishes a value for a dwelling that cannot be obtained from public sources. For example, if a tax-assessed value maintained by the County or Parish Assessor was obtained and the bank has done nothing to modify that value, it is not considered a valuation. This unaltered value is also readily available to the applicant. On the other hand, if the bank takes the assessor’s value and adjusts it 10% based on comparable dwellings, the bank has created a valuation, for the purpose of Regulation B. Additionally, since this value is not publically available to the applicant, it would fall under the appraisal notice and free copy requirements of Regulation B.

§ 1002.14 Rules on providing appraisals and other valuations

(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.

Another common example of a valuation is numerical values from secondary market underwriting programs. For example, if the underwriting system returns a value for the dwelling, it is not publically available and is therefore considered an appraisal and is subject to the rule. If the bank manually enters a value into the underwriting program, it could also be considered a valuation depending on the circumstances. It all depends on where the entered value was derived from. For example, if the tax-assessed value is entered, it’s not a valuation. If the value entered is from a previously obtained appraisal, it is probable that the requirements were not triggered because it’s not a new appraisal (developed in connection with that application). Hopefully, further clarification will be issued on these “gray” areas.
Notice Requirements

When a commercial lender has a request for credit and it’s subject to the appraisal rule. The next step is to provide the appraisal notice. The notice must be provided within 3 business days of an application (request for credit). The notice does not have to be provided to each applicant, rather one applicant (must be the primary applicant, when apparent) can receive the notice on behalf of all applicants. The notice may be provided electronically; however, it must comply with E-SIGN. The only exception is if the notice is provided on or with an application that can be accessed electronically.

NOTICE LANGUAGE

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.

Exemptions and reminders

A request for credit that will be secured by a first lien on a dwelling WILL trigger the requirements and section 1002.14 applies. For example, the loan type doesn’t matter. In other words, the rule will apply whether the request is for a construction loan, bridge loan, HELOC or a commercial or agricultural loan or line of credit. Be careful with cross-collateralization clauses. A commercial lender may have a covered application and not even realize it.

The rule also does not make exceptions for occupancy status, whether the dwelling is taken as an abundance of caution or whether the dwelling has little value relative to the amount requested. REPEAT REMINDER: If the request will be secured by a first lien on a dwelling and an appraisal will be obtained, the bank owes a notice and copy of the appraisal/valuation used in connection with the REQUEST.

Business Days

The notice must be provided within 3 business days of application. The CFPB failed to define “business days” within the Regulation, which has created confusion. They have; however, indicated that a “reasonable” definition is sufficient. One prudent option would be to adopt Regulation Z’s definition since there is a very similar appraisal requirement for Higher-Priced Mortgage Loans. It defines a business day (for these purposes) as “a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions”. To demonstrate the 3- business day delivery, assume the application is received on Monday. The notice should then be provided or placed in the mail by the end of business Thursday.
Appraisal Copy

Once the appraisal is completed and reviewed by the bank to make sure it meets the bank’s standards and adequately documents the value of the property, a copy must be provided to the applicant promptly. When the appraisal is considered “complete” can occur at any time during the loan process; however, the copy generally cannot be provided less than 3 business days prior to closing (unless the applicant requested and executed a waiver). If the free copy is delivered in person, the loan can close in three business days. For example, a copy is hand-delivered on Monday the loan can be closed on Thursday. If the free copy is mailed, three business days must be allowed for it to be considered “delivered”, then an additional three business days must pass before the loan can be closed. If the bank is open on Saturday and the copy is mailed on Monday, the loan can be closed on the following Monday. The copy may also be provided electronically; however, it must comply with E-SIGN.

Previous Appraisals

If a bank intends to rely on a prior appraisal, the notice and copy requirements will NOT apply.

Regulation B states, in §1002.14(a)(1), you must provide a copy of any appraisal or other written valuation developed in connection with an application that is to be secured by a first lien on a 1-4 family dwelling.

The key here is “developed in connection with”. In other words, if an application is received and the lenders relied and used an existing appraisal that was developed for another loan, there is NO covered application. This means the appraisal notice isn’t technically required under §1002.14(a)(2) and neither is the free copy under §1002.14(a)(1). However, it may be prudent to provide the notice, in case an update is made to a previously developed value. The Commentary to §1002.14(a)(1) helps to further understand the “developed in connection with” requirement and also provides clarification as to how this section applies to loan renewals. It states, if

“a new appraisal is developed in connection with an application for a renewal, it is a covered application

Translation in English: the notice and free copy are required. However, when an application for a renewal includes a reliance on a previously developed appraisal, it is not a covered application; this means no notice and no free copy.
FAIR LENDING LAWS AND TYPES OF DISCRIMINATION

Equal Credit Opportunity Act (Regulation B)
The purpose of the ECOA is to promote the availability of credit to all creditworthy applicants without regard to any of the prohibited bases. The regulation does not attempt to dictate standards of creditworthiness. It does, however, try to strike a balance between your need as a lender to know about the applicant and the applicant’s right to privacy regarding questions that have no bearing on his/her creditworthiness. Regulation B applies to both consumer and business purpose credit. The difference is found in adverse action notification requirements. 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
- The applicant’s exercise, in good faith, of any right under the Consumer Credit Protection Act.

The Federal Reserve Board’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.

Coverage: All Creditors
Agency/Citation: Equal Credit Opportunity Act, Title VII of the Consumer Credit Protection Act, as amended at 15 USC 1601; Federal Reserve Board/Regulation B at 12 CFR Part 1002.
Effective Date: Equal Credit Opportunity Act – 1976

Background
The Equal Credit Opportunity Act (ECOA) and its implementing rule, Regulation B ("Reg B"), are part of the Consumer Credit Protection Act, which also includes Truth-In-Lending. ECOA is intended generally to "promote the availability of credit to all creditworthy applicants, without regard to race, color, religion, national origin, sex, marital status, or age," as long as the applicant has the legal ability to enter into a contract. It is a violation of ECOA and Reg B to deny credit based on these factors. Also, creditors may not deny credit based on the fact that an applicant receives public assistance or has exercised a right under the Consumer Credit Protection Act.

The rule requires creditors to notify applicants of action taken on applications; to report credit histories in the name of both spouses, if applicable; to retain records of compliance; and to collect information for monitoring purposes about an applicant applying for a purchase-money mortgage loan. (Although Reg B applies to all creditors, the term "financial institution" will be used throughout this summary.)
General Rule Prohibiting Discrimination (Section 1002.4)

Reg B prohibits financial institutions from discriminating against an applicant on a prohibited basis regarding any aspect of a credit transaction. As mentioned above, the prohibited bases are: race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract); the fact that all or part of the applicant's income derives from a public assistance program; or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act.

**1002.4 General rules.**

(a) *Discrimination.* A creditor shall not discriminate against an applicant on a prohibited basis regarding any aspect of a credit transaction.

(b) *Discouragement.* A creditor shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage on a prohibited basis a reasonable person from making or pursuing an application.

(c) *Written applications.* A creditor shall take written applications for the dwelling-related types of credit covered by §1002.13(a).

(d) *Form of disclosures - (1) General rule.* A creditor that provides in writing any disclosures or information required by this regulation must provide the disclosures in a clear and conspicuous manner and, except for the disclosures required by §§1002.5 and 1002.13, in a form the applicant may retain.

(2) *Disclosures in electronic form.* The disclosures required by this part that are required to be given in writing 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.). Where the disclosures under §§1002.5(b)(1), 1002.5(b)(2), 1002.5(d)(1), 1002.5(d)(2), 1002.13, and 1002.14(a)(2)(i) accompany an application accessed by the applicant in electronic form, these disclosures may be provided to the applicant in electronic form on or with the application form, without regard to the consumer consent or other provisions of the E-Sign Act.

(e) *Foreign-language disclosures.* Disclosures may be made in languages other than English, provided they are available in English upon request.
Types of Discrimination The courts have recognized three methods of proof of lending discrimination under the ECOA (and the Fair Housing Act):

- "Overt evidence of discrimination," when a lender blatantly discriminates on a prohibited basis;
- Evidence of "disparate treatment," when a lender treats applicants differently based on one of the prohibited factors; and
- Evidence of "disparate impact," when a lender applies a practice uniformly to all applicants but the practice has a discriminatory effect on a prohibited basis and is not justified by business necessity.

Overt Evidence of Discrimination
There is overt evidence of discrimination when a bank openly discriminates on a prohibited basis. There is overt evidence of discrimination even when a bank 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 FHAAct’s prohibition on statements expressing a discriminatory preference as well as Section 1002.5(a) of Regulation B, which prohibits discouraging applicants on a prohibited basis.

There is overt evidence of discrimination when a bank openly discriminates on a prohibited basis. For example, a bank offers a credit card with a limit of up to $750 for applicants aged 21-30 and $1500 for applicants over 30. This policy violates the ECOA's prohibition on discrimination based on age.

Disparate Treatment

Evidence of Disparate Treatment.

Disparate treatment occurs when a lender treats an applicant differently based on one of the prohibited bases. Disparate treatment ranges from overt discrimination to more subtle disparities in treatment. It does not require any proof that the treatment was motivated by prejudice or a conscious intention to discriminate against a person beyond the difference in treatment itself. It is considered by courts to be intentional discrimination because no credible, nondiscriminatory reason explains the difference in treatment on a prohibited basis. There is overt evidence of discrimination when a lender openly discriminates on a prohibited basis.

Example:
For example, two minority loan applicants are told that it will take several hours and require the payment of an application fee to determine whether they will qualify for a home mortgage loan. In contrast, a loan officer takes financial information immediately from non-minority applicants and determines whether they are qualified in minutes, without charging a fee. The financial institution's differential treatment violates both the ECOA and the Fair Housing Act.
Evidence of Disparate Impact

When a bank applies a policy or practice equally to credit applicants, but the policy or practice has a "disproportionate adverse impact" on applicants from a group protected against discrimination, the policy or practice is described as having a "disparate impact." Policies and practices that are neutral on their face and that are applied equally may still, on a prohibited basis, disproportionately and adversely affect a person's access to credit. The fact that a policy or practice creates a disparity on a prohibited basis is not alone proof of a violation. Where the policy or practice is justified by "business necessity" and there is no less discriminatory alternative, a violation of the ECOA or Fair Housing Act will not exist.

Source: 1994 Interagency Policy Statement on Discrimination in Lending

**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.

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.
TAKING APPLICATIONS

Taking Applications (Section 1002.5)

Reg B prohibits financial institutions from making any oral or written statement to applicants or prospective applicants that would discourage on a prohibited basis a "reasonable person" from making or pursuing an application. This prohibition includes everything from advertisements to prescreening techniques used by the bank to attract potential borrowers. For example, a financial institution's advertisements may not encourage some types of borrowers or discourage others based on their race, sex, national origin, etc. Therefore, the selective use of newspapers, magazines, radio or TV stations with a "well-defined" audience that would tend not to include, as a class, members of one or more of the protected categories of potential customers, is also prohibited.

The prohibition against discouraging applicants applies to written, oral, or telephone inquiries and applications. For example, if loan officers utilize scripts during the prescreening or application process, the questions must be neutral, and of a type applicable to and asked of every applicant who wants the same kind and amount of credit.

Information about a spouse or former spouse. Banks are generally prohibited from requesting information about an applicant's spouse or former spouse, unless:

- 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 property on which the applicant is relying as a basis for repayment of the credit requested is located in such a state; 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. The financial institution may request an applicant to list any account upon which he or she is liable, and to provide the name and address in which the account is carried. The financial institution may also ask the names in which an applicant has previously received credit.

Inquiries concerning marital status. If an applicant applies for individual unsecured credit, the financial institution is prohibited from inquiring 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 (joint and/or secured credit), a financial institution may inquire about the applicant's marital status, but may use only the terms married, unmarried, and separated. A financial institution may explain that the category "unmarried" includes single, divorced, and widowed persons.
Disclosure about income from alimony, child support, or separate maintenance. A financial institution is prohibited from inquiring whether income stated in an application is derived from alimony, child support, or separate maintenance payments unless the financial institution discloses to the applicant that such income need not be revealed if the applicant does not want the financial institution to consider it in determining the applicant's creditworthiness.

Gender. A financial institution may not inquire about the sex of an applicant. 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 may otherwise use only terms that are neutral as to sex.

Childbearing, childrearing. A financial institution may not inquire about birth control practices, intentions concerning the bearing or rearing of children, or capability to bear children. A financial institution 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.

Race, color, religion, national origin. The financial institution may not inquire about the race, color, religion, or national origin of an applicant or any other person in connection with a credit transaction. However, the financial institution may inquire about an applicant's permanent residence and immigration status.

Written applications. A financial institution may take written applications for loans secured by the applicant's dwelling, but need not take written applications for other types of credit. Financial institutions are required to request certain information for these types of loans for government monitoring purposes, as required by Section 1002.13 of the regulation.

Providing Appraisal Reports (Section 1002.14) _NEW January 18, 2014_ Section 1002.14 of Reg B requires that creditors provide copies of appraisals used in connection with an application for credit that is to be secured by a FIRST lien on a dwelling. There is also a notice requirement, and the appraisal or other valuation must be provided promptly upon completion or at least 3 business days prior to consummation or account opening, whichever is earlier.
§ 1002.5  Rules concerning requests for information.

(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.¹

¹ 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 regulation, 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).

(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.
(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.

(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.

(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.

(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.
(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.

COMMENTARY – partial

Section 1002.5—Rules Concerning Requests for Information

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.

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.
ADVERSE ACTION NOTIFICATIONS

The financial institution must notify all applicants of its credit decision, whether favorable or adverse. A favorable decision can be communicated in a letter or conversation, or by issuing a requested credit card or loan proceeds. An adverse decision ("adverse action") requires the financial institution to provide information regarding why the application was denied, and what the applicant's rights are if he or she believes the application was rejected on a prohibited basis.

What is an "adverse action"? Reg B defines the term adverse action as:
• a refusal to grant credit in substantially the amount or on substantially the terms requested in an application unless the financial institution makes a counteroffer (to grant credit in a different amount or on other terms) and the applicant uses or expressly accepts the credit offered;
• a termination of an account or an unfavorable change in the terms of an account that does not affect all or a substantially all of a class of the financial institution's accounts; or
• a refusal to increase the amount of credit available to an applicant who has made an application for an increase.

Adverse action does not include:
• a change in the terms of an account expressly agreed to by an applicant.
• any action or forbearance relating to an account taken in connection with inactivity, default, or delinquency as to that account;
• a refusal or failure to authorize an account transaction at a 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 a substantial portion of a class of the financial institution's accounts, or when the refusal is a denial of an application for an increase in the amount of credit available under the account;
• a refusal to extend credit because applicable law prohibits the financial institution from extending the credit requested; or
• a refusal to extend credit because the financial institution does not offer the type of credit or credit plan requested.

Financial institutions must provide applicants with a notification of action taken, ECOA notice, and a statement of specific reasons. Notification is required within:
• 30 days after receiving a completed application concerning the financial institution's approval of, counteroffer to, or adverse action on the application;
• 30 days after taking adverse action on an incomplete application, unless notice is provided in accordance with paragraph (c) of this section;
• 30 days after taking adverse action on an existing account; or
• 90 days after notifying the applicant of a counteroffer if the applicant does not expressly accept or use the credit offered.

Content of notification when adverse action is taken. A notification given to an applicant when adverse action is taken must be in writing and must contain: a statement of the action taken; the name and address of the financial institution; the name and address of the Federal agency that administers compliance with respect to the financial institution; 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 within 30 days, if
the statement is requested within 60 days of the financial institution's notification. The
disclosure must include the name, address, and telephone number of the person or office
from which the statement of reasons can be obtained. If the financial institution chooses
to provide the reasons orally, the financial institution must also disclose the applicant's
right to have them confirmed in writing within 30 days of receiving a written request for
confirmation from the applicant.

**Statement of specific reasons.** The statement of reasons for adverse action must be specific and
indicate the principal reason(s) for the adverse action. Statements that the adverse action was
based on the financial institution's internal standards or policies or that the applicant failed to
achieve the qualifying score on the financial institution's credit scoring system are insufficient.
Here are some specific reasons for denial, excerpted from one of the regulation's sample notices

<table>
<thead>
<tr>
<th>Credit application incomplete</th>
<th>Length of residence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insufficient number of credit references provided</td>
<td>Temporary residence</td>
</tr>
<tr>
<td>Unacceptable type of credit references provided</td>
<td>Unable to verify residence</td>
</tr>
<tr>
<td>Unable to verify credit references</td>
<td>No credit file</td>
</tr>
<tr>
<td>Temporary or irregular employment</td>
<td>Limited credit experience</td>
</tr>
<tr>
<td>Unable to verify employment</td>
<td>Poor credit performance with us</td>
</tr>
<tr>
<td>Length of employment</td>
<td>Delinquent past or present credit obligations with others</td>
</tr>
<tr>
<td>Income insufficient for amount of credit requested</td>
<td>Garnishment, attachment, foreclosure, repossession, collection action, or</td>
</tr>
<tr>
<td>Excessive obligations in relation to income</td>
<td>judgment</td>
</tr>
<tr>
<td>Unable to verify income</td>
<td>Bankruptcy</td>
</tr>
<tr>
<td></td>
<td>Value or type of collateral not sufficient</td>
</tr>
</tbody>
</table>

**NOTE:** (Form C-1): Notification to business credit applicants

• The statement of the action taken may be given orally or in writing, when adverse action
is taken; disclosure of an applicant's right to a statement of reasons may be given at the
time of application, instead of when adverse action is taken, provided the disclosure is in
a form the applicant may retain and contains the information.

• For an application made solely by telephone, a financial institution satisfies the
requirements of this paragraph by an oral statement of the action taken and of the
applicant's right to a statement of reasons for adverse action.

➢ For a business that had gross revenues in excess of $1,000,000 in its preceding fiscal year
or an extension of trade credit, credit incident to a factoring agreement, or other similar
types of business credit, a financial institution may: notify the applicant, orally or in
writing, within a reasonable time of the action taken; and provide a written statement of
the reasons for adverse action and the ECOA notice if the applicant makes a written
request for the reasons within 60 days of being notified of the adverse action.
FLOOD DISASTER PROTECTION ACT

Flood Insurance Act

The National Flood Act (42 U.S.C. 4001-4129) became law in 1968. The Flood Disaster Protection Act of 1973 and the National Flood Insurance Reform Act of 1994 amended the original law. The Flood Disaster Protection Act (FDPA) was created to help communities in flood-prone areas to improve access to federal relief programs and increase flood insurance coverage. Because of increased flood activity in recent years, examiners have also paid closer attention to how well a financial institution complies with the requirements of the FDPA.

The fines for violating the FDPA were $350 per violation with an annually adjusted cap (it had been between $125,000 and $132,000) per calendar year. If there’s a pattern of non-compliance, the financial institution may also be fined additional penalties. The law had been amended with passage of the Biggert-Waters provisions; it adjusts the penalty for each violation to $2,000 and the annual cap has been removed! Penalties after July 6, 2012 can be made at the higher rate.

Regulations

The regulatory agencies, have adopted substantially similar regulations to implement the law.

<table>
<thead>
<tr>
<th>Agency</th>
<th>Code</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDIC</td>
<td>12 CFR Part 339</td>
</tr>
<tr>
<td>Federal Reserve</td>
<td>12 CFR Part 208</td>
</tr>
<tr>
<td>OCC</td>
<td>12 CFR Part 22, 172</td>
</tr>
</tbody>
</table>

Purpose – The purpose of the laws and the regulations is to:

- Provide subsidized insurance to flood-prone areas;
- Require local jurisdictions to enact land use and flood control measures;
- Require flood insurance for loans secured by a building or a mobile home located in a special flood hazard area in a participating community; and
- Provide notice of the risk of flooding and the availability of subsidized flood insurance to owners of buildings and mobile home located in special flood hazard areas.

- NOTE: This is not a typical “consumer” compliance protection law. The purpose of the law is to protect the GOVERNMENT’S program for flood insurance for residential AND commercial property. Lenders have been “deputized” to enforce the provisions. IT IS COLLATERAL DRIVEN – NOT PURPOSE DRIVEN!!
COVERAGE OF FLOOD REGULATION

General Rule
The regulations apply when (MIRE) making, increasing, renewing or extending a loan:

- Secured by a building or a mobile home
- Located or to be located in an area determined by the Director of the Federal Emergency Management Agency to have special flood hazards.

Note: Sections dealing with conducting and documenting determinations (and the fees charged for conducting a determination) apply to loans secured by buildings or mobile homes, regardless of location.

Designated Loan
The term means a loan secured by a building or mobile home that is located or to be located in a special flood hazard area in a participating community.

Building
The term means a walled and roofed structure, other than a gas or liquid storage tank, that is principally above ground and affixed to a permanent site, and a walled and roofed structure while in the course of construction, alteration, or repair.

Mobile Home
The term means a structure, transportable in one or more sections, that is built on a permanent chassis and designed for use with or without a permanent foundation when attached to the required utilities. For purposes of this part, the term mobile home means a mobile home on a permanent foundation. The term mobile home includes a manufactured home as that term is used in the NFIP. Note: The term mobile home does not include a recreational vehicle.

Special Flood Hazard Area
The term means the land in the flood plain within a community having at least a one percent chance of flooding in any given year, as designated by the Director of FEMA.

Participating Community
The term means a community that has fulfilled the requirements for participating in the NFIP and in which flood insurance is currently being sold.

Non-participating Community
The term means a community located in an area having special flood hazards, but is not participating in the NFIP.

Community Status Information
Information about a community, its status (participating or non-participating) and the date of the current map is located on FEMA’s website at http://www.fema.gov/fema/csb.shtm.
**Purchased Loans**

The purchase of a loan is not an event that requires the purchaser to make a new determination at the time of purchase. However, if the lender becomes aware at some point during the life of the loan that flood insurance is required, then the lender must comply with the Regulation. Similarly, if the lender extends, increases or renews the loan, the Regulation applies.

**Table-Funded Loans**

Loans made through a table funding process are treated as though the party providing the funds has originated the loan. The funding party must comply with the Regulation.
WHAT IS INSURABLE?

Any “building or mobile home” securing a loan and any personal property securing such loan located in a building or mobile home securing a ‘loan’ must be ‘covered’ for the full term of the loan by flood insurance.” This means any insurable structure located in a flood-hazard zone must be covered by an appropriate amount of flood insurance. An insurable structure is a structure with at least two load-bearing walls and a roof. It must be affixed to land, and at least 50 percent of its value must be above ground. There is a NEW EXCEPTION FOR CERTAIN DETACHED NON-RESIDENTIAL STRUCTURES on a RESIDENTIAL PROPERTY (this will be covered in the UPDATE section)

NOTE: This press release was made June 22, 2015

Agencies Issue Flood Insurance Rule

Five federal regulatory agencies today announced the approval of a joint final rule that modifies regulations that apply to loans secured by properties located in special flood hazard areas. The final rule implements provisions of the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA) relating to the escrowing of flood insurance payments and the exemption of certain detached structures from the mandatory flood insurance purchase requirement. The final rule also implements provisions in the Biggert-Waters Flood Insurance Reform Act of 2012 (the Biggert-Waters Act) relating to the force placement of flood insurance

Examples of buildings that are NOT insurable would include buildings built completely over water, like a boathouse.

Buildings under construction are covered. Insurability begins the moment construction begins on any part of the building above the slab, and continues throughout construction. However, coverage stops if construction halts for 90 continuous days or more.

Mobile homes are covered if the following three conditions exist:

1. The mobile home must rest on a permanent foundation, meaning no weight rests on any wheels or axles. The foundation may be as simple as concrete blocks, even if they’re non-continuous. The foundation must be able to resist flotation, collapse, or lateral movement.
2. The mobile home must be anchored to the foundation according to the community tie-down regulations. (There’s a prize to the first person who knows what they are locally)
3. The mobile home must be connected to utilities.

If these three conditions are met, any loan secured by a mobile home, regardless of whether the land it sits upon is owned or rented by the borrower, and regardless of whether the land secures the loan, must be covered by flood insurance. If the mobile home does not meet these standards, flood insurance is not mandatory.
CONTENTS COVERAGE

The rules also require coverage of the contents of insurable structures, if the contents also secure the loan. This means property stored inside buildings covered by flood insurance must also be insured, subject to certain rules. Property stored in the basement of a structure is not insurable unless it is necessary to the maintenance of the building. Personal property stored outside the building is not insurable, but property that is normally stored outside that is now stored inside an insurable structure, such as crops that are stored in an insurable storage building after harvest, is insurable. Mobile property, such as an automobile or trailer, normally stored inside an insurable structure like a garage is not insurable, as these can be easily removed in the event of a flood.

Lenders should be particularly cautious about content coverage on loans secured by commercial real estate. Taking contents (inventory or equipment) is a common practice with commercial loans. In this case contents coverage must also be purchased.

<table>
<thead>
<tr>
<th>IF A LOAN IS…</th>
<th>THEN FLOOD INSURANCE IS…</th>
</tr>
</thead>
<tbody>
<tr>
<td>To finance inventory stored in a building located within an SFHA, but the loan is not secured by the building</td>
<td>Not required for the building or the contents stored in that building.</td>
</tr>
<tr>
<td>Secured by a building and contents, the building is located in an SFHA in a participating community</td>
<td>Required for the building and any contents stored in that building.</td>
</tr>
<tr>
<td>Secured by contents located in buildings other than the building securing the loan</td>
<td>Not required on those</td>
</tr>
</tbody>
</table>

A common circumstance surrounding this violation was the lack of contents coverage for commercial loans. Examiners often referenced their reviews of loan files where a bank makes a commercial loan secured by a building in a Special Flood Hazard Area. The loans were also secured by contents stored within that building. In these cases, the bank obtained flood insurance for the building but not the contents in the building.

Flood insurance for contents is required when you take a security interest in contents and a building, the subject building is located in a Special Flood Hazard Area, and the contents are stored in that building. Contents coverage is required only when all three factors are met. In some instances, the bank’s commercial lending area was simply not aware of the requirements associated with flood insurance on contents. In other instances, this violation occurred when the underwriting process did not factor in the value of contents as collateral, but the bank used a mortgage or security agreement that took contents as collateral.
What are the coverage provisions?

<table>
<thead>
<tr>
<th>Building Coverage</th>
<th>Emergency Program</th>
<th>Regular Program</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Family Dwelling</td>
<td>$35,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>2-4 Family Dwelling</td>
<td>$35,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>5+ Family Dwelling</td>
<td>$100,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>Non-Residential</td>
<td>$100,000</td>
<td>$500,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Contents Coverage</th>
<th>Emergency Program</th>
<th>Regular Program</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>$10,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>Non-Residential</td>
<td>$100,000</td>
<td>$500,000</td>
</tr>
</tbody>
</table>

The flood insurance requirements apply to all loans secured by structures in flood-hazard areas. The rules apply equally to junior mortgages, open or closed-end loans, refinances, purchase money, construction and even when the real estate is taken as an “abundance of caution”.

SPECIAL NOTE FOR COMMERCIAL LENDERS:

41. Does the Regulation apply where the lender takes a security interest in a building or mobile home located in an SFHA only as an “abundance of caution”?  

Answer: Yes. The Act and Regulation look to the collateral securing the loan. If the lender takes a security interest in improved real estate located in an SFHA, then flood insurance is required.
STANDARD FLOOD HAZARD DETERMINATION FORM

The determination of whether a structure is in a special flood-hazard area may be made by the financial institution or by a third party. If a check of the maps shows that any part of a structure lies in the flood-hazard area, the entire structure must be covered by flood insurance. On the other hand, if part of the land taken as collateral is located in a flood-hazard area, but none of the structure itself is in the flood-hazard area, no insurance is required. Land may not be insured against flood, only structures.

A fee may be charged to the borrower for making the determination that’s made by a third party. Determinations made by a third party may be used only if the accuracy for making the determination is guaranteed by the third party. Ultimately, the financial institution is responsible for the accuracy of the determination and the only party who can make the final decision as to whether flood insurance is required for the loan.

Lender’s Responsibility

It is the lender’s responsibility to determine if a building or mobile home offered as collateral for a loan is or will be located in a special flood hazard area. The lender must also determine if the area is a participating or a non-participating community.

- 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 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.
- 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.

Third Party

The lender remains responsible for the determinations, even if it contracts with a third party to perform such services. Any third party performing determination services must guarantee the accuracy of the information provided.

The Flood Insurance Administration (FIA) maintains a list of Flood Zone Determination Companies. The list reflects companies that have contacted FIA or maintained contact with FIA about the services they offer relating to the NFIP. FIA attempts to maintain the list as current, but relies on information provided by these companies.
Use of Form
A lender must use the standard flood hazard determination form (SFHDF) to document the determination. The SFHDF may be used in a printed, computerized, or electronic manner.

Note: While it may be a common practice in some areas for lenders to provide a copy of the SFHDF to the borrower to give to the insurance agent, lenders are neither required nor prohibited from providing the borrower with a copy of the form. **The borrower’s signature is not required on the SFHDF, but proof of receipt of the notice if a property is located in a SFHA IS required.**

Duration of the Form
A lender may rely on a previous determination using the SFHDF when increasing, extending, renewing or purchasing a loan secured by a building or a mobile home. The lender may rely on the previous determination if:

- A subsequent loan involving a refinancing or assumption is made:
  - on the same property;
  - by the same lender who obtained the original determination; and
- The other requirements contained in Section 528 are met.

Note: The Act omits the “making” of a loan as a permissible event to rely on a previous determination. A refinancing or assumption made by a lender other than the lender who obtained the original determination constitutes “making” a new loan, thereby requiring a new determination.

Section 528 Requirements
Section 528 of the Act requires that a lender may rely on a previous determination only if:

- The original determination was recorded on the SFHDF;
- The original determination was made within the previous seven years; and
- There were no map revisions or updates affecting the security property since the original determination was made.

Retention of Form
A lender shall retain a copy of the completed determination form, in either hard copy or electronic form, for the period of time the lender owns the loan.
NEW STANDARD FLOOD DETERMINATION FORM
NOTE: Resource Record Details – this is from the FEMA library
The Standard Flood Hazard Determination Form

The new form FEMA Form is 086-0-32 and expired May 31, 2015 but this is the most current form available; new fields have been added for property address, parcel number, LOMA/LOMR case numbers.

Link:

http://www.fema.gov/media-library/assets/documents/225

This is the warning on the FEMA website about the new form:

Please review the new form carefully. The Agency will be allowing users a three year transition period ending on the expiration date so user systems can be changed before final adoption of the form is required. The previous form can be used until that time. Users may choose to update their systems at any time to the new format.
OVERVIEW OF FLOOD CHANGE

On June 22, 2015, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), the Farm Credit Administration (FCA) and the National Credit Union Administration (NCUA) (collectively, the Agencies) issued a joint Final Rule modifying regulations applicable to loans secured by properties located in special flood hazard areas.

This final rule implements certain provisions of both the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA) and the Biggert-Waters Flood Insurance Reform Act. Certain provisions of this Final Rule will go into effect October 1, 2015; and others January 1, 2016.

Implementation Dates:
The escrow requirement and option to escrow provisions are mandated by statute and are effective on January 1, 2016.

✓ As of January 1, 2016, lenders and servicers must escrow premiums and fees for flood insurance for any designated loan secured by residential improved real estate or a mobile home when “making, increasing, renewing, or extending” (MIRE events) a designated loan.
✓ As of June 30, 2016, lenders and servicers must have distributed notices providing the option to escrow to all loans outstanding on January 1, 2016.
✓ Revisions to Appendix A and new Appendix B are effective on January 1, 2016.
✓ The forced-placement provisions were effective upon enactment of the BWA, and the detached structures provisions were effective upon enactment of HFIAA. However, lenders and servicers must adjust their systems to reflect compliance with any clarifications to those provisions provided by the rule by no later than October 1, 2015.

The final rule:
1. Exempts certain detached structures from the mandatory flood insurance purchase requirement;
2. Implements provisions regarding the force placement of flood insurance;
3. Requires servicers to escrow flood insurance premiums for certain loans secured by residential improved real estate (or a mobile home);
4. Amends the current “Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance” form. Specifically, language was added concerning the escrow requirement and coverage for detached structures; and
5. Provides verbiage for an “Option to Escrow for Outstanding Loans” notice that will assist institutions in informing existing borrowers about their “option” to escrow flood insurance premiums and fees, as required.

**Private flood insurance provisions will be addressed in a separate rulemaking.**
Key Elements of the Final Rule:
The Final Rule reaffirms the mandatory purchase requirement, that a lender or servicer may not make, increase, renew, or extend a 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.

- Designated loans are loans secured by a building or mobile home located in a special flood hazard area in which flood insurance is available.

Detached Structures:
The Final Rule provides that flood insurance is not required on any structure on a residential property if it is detached from the primary residential structure and does not serve as a residence.

The original FDPA contained a requirement that any building – even a low value detached structure – securing a designated loan must be insured. The HFIAA amendments recognized that insurance on these structures – such as a storage shed or a garage – can add considerable costs for the borrower while adding minimal value, and permitted that these structures may be exempt, subject to certain provisions.

The exemption applies to loans made for business, commercial, or agricultural purposes, in addition to consumer loans, if they are secured by a residence.

- The purpose of the loan does not change the value of the detached structure, or the lack thereof.

The exemption gives banks significant discretion to determine which structures require coverage.

- The exemption applies only to structures that the lender or servicer deems part of the residential property.
- When detached structures are given as collateral, lenders and servicers may require the structure be covered regardless. In this instance, the structures themselves – such as detached greenhouses – have value to the bank and the borrower, and accordingly do not meet the purpose of the exception.
The Final Rule provides some clarification of the terms “residential property,” “detached,” and “serve as a residence.”

- “Residential property” applies only to structures for which there is a residential use (personal, family, or household purpose) and not to structures for which there is a commercial, agricultural, or other business use.

- A structure is “detached” from the primary residential structure if it is not joined by any structural connection to the residential structure – i.e., it stands alone.

- A detached structure “serves as a residence” based upon a good faith determination of the lender of the structure’s intended use. The Agencies have declined to provide a bright line test for this good faith determination, and accordingly, the lender or servicer has significant discretion, but is called upon to do a case-by-case analysis.

Although no single question is dispositive, lenders and servicers might consider and document some of the following considerations in their good-faith determinations of whether a detached structure serves as a residence:

- Has the borrower indicated the structure will be used as a residence?
- Does the structure have bathroom facilities?
- Does the structure have kitchen facilities?
- Does the structure have sleeping facilities?
- Is the structure traditionally used as a residence? (a guest house).
- Is the structure traditionally used for some purpose other than a residence? (a green house, a horse barn, a tool shed)

Although active monitoring of whether a detached structure qualifies for the exemption is not required, detached structures should be re-examined upon a MIRE event to determine if the coverage determination remains reasonable. If a lender or servicer subsequently becomes aware that a detached structure is no longer exempt, the borrower must be notified that insurance is required, and if insurance is not placed within 45 days of that notification, the lender must force-place it.
COMMON FLOOD VIOLATIONS
These common violations are included in the FDIC video on the topic.

This is link to the video series for flood insurance:
https://www.fdic.gov/regulations/resources/director/technical/flood.html
There is a “NOTICE TO VIEWERS”

NOTICE TO VIEWERS
The video indicates that the Biggert-Waters Act revised the escrow requirements, however, the law has changed since the video was produced. The Homeowner Flood Insurance Affordability Act, enacted in March 2014, amended changes made by the Biggert-Waters Act to the escrow provisions of federal flood insurance law (i.e., banks and servicers will be required under the new law to escrow flood insurance premiums and fees for any loans made, increased, extended, renewed, or refinanced on or after January 1, 2016) and also provided a new exclusion for detached structures on residential property, and the video indicates that the increase in the maximum insurance coverage for residential multi-family properties mandated by the Biggert-Waters Act is not yet effective. However, since the video was produced, FEMA implemented the increase to the maximum flood insurance coverage for non-condominium residential multi-family buildings from $250,000 to $500,000, and FEMA indicated that the coverage is effective on June 1, 2014 (see FIL-28-2014).

The videos will be updated to incorporate these and any future legal or program changes
Purchase Flood Insurance

- The requirement to purchase flood insurance if the improved real property is located in a flood hazard zone is absolute. No one can waive the requirement (not even the CEO) and no one can be permitted to close a loan without adequate coverage being in place.
- The determination must be made before closing. Check the dates on flood determination forms and compare the dates with application and closing dates.
- If determinations are occurring too close to closing (like the day before), work with lending staff to make flood determinations earlier in the underwriting process - with appraisals, for example.
- Most of the violations are found in the commercial lending area. Implement a method for holding the commercial lenders accountable for flood insurance lapses of any kind.
- Establish a system for reviewing flood insurance renewals. Give special attention to loans that do not have escrow accounts.

SFHDF – Standard Determination Form

- Use the correct form. This should be easy! Forms should not be expired (note there is a long transition period for the current “new” form)
- Be sure the completed form is in each real estate-secured loan file.
- Review forms periodically for completeness. The form should be fully and correctly filled out.
- Complete a form for EACH structure or clearly designate the determination of EACH structure on the SHFDF

Force Placement of Insurance

- Have a review system in place to verify the adequacy of insurance whenever a covered loan is made, increased, renewed, or extended.
- Have written procedures for the requirements of force placement of insurance including notification letters and any timing requirements enforced by your primary regulator.
- Use life of loan monitoring to become informed of map changes; IMPORTANT – If you are notified of a change and a property was not previously in a SFHA and is now in a SFHA because of a mapping change, action must be taken to notify the borrower and get adequate coverage in place for the remaining life of the loan.

Notice of Insurance

- When the property is in a flood hazard area, the notices are important. Get the notice right.
- Use FEMA's notice form and be sure the information is complete.
- Get the notice to the customer on time. The customer must have sufficient opportunity to purchase flood insurance before closing. This means the determination should be done well before closing. If insurance is required, send the notice immediately.
- Keep proof that you sent the notice. This can include a signed copy of the notice, a letter that the borrower acknowledges receiving the notice, a scanned receipt of the notice.
FLOOD INSURANCE CALCULATION EXAMPLES

- How does a bank calculate the appropriate amount of insurance?
  - Compare three values: (1) The maximum amount of insurance available under the National Flood Insurance Program, commonly referred to as NFIP, (2) the insurable value of the property, and (3) the principal loan amount(s) outstanding. The lesser of the three is the minimum required amount of coverage.

<table>
<thead>
<tr>
<th>Property Type</th>
<th>Current NFIP Limits</th>
<th>Biggert-Waters Act (not yet effective)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>$250,000</td>
<td>Same</td>
</tr>
<tr>
<td>Residential – Multi-Family</td>
<td>$250,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>Commercial</td>
<td>$500,000</td>
<td>Same</td>
</tr>
<tr>
<td>Personal Contents</td>
<td>$100,000</td>
<td>Same</td>
</tr>
<tr>
<td>Commercial Contents</td>
<td>$500,000</td>
<td>Same</td>
</tr>
</tbody>
</table>

**Commercial Building Example**

| Loan Amount        | $1,000,000          |
| Insurable Value    | $1,000,000          |
| Maximum Available Insurance | $500,000 |
| Minimum Required Flood Insurance Coverage | $500,000 |
### Commercial Buildings and Home Example

<table>
<thead>
<tr>
<th>Structure</th>
<th>(A) Insurable Value</th>
<th>(B) Max NFIP Available</th>
<th>(C) Lesser of A and B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single-Family</td>
<td>$200,000</td>
<td>$250,000</td>
<td>$200,000</td>
</tr>
<tr>
<td>Commercial #1</td>
<td>$1,000,000</td>
<td>$500,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>Commercial #2</td>
<td>$300,000</td>
<td>$500,000</td>
<td>$300,000</td>
</tr>
<tr>
<td>Aggregate of Maximum Building Coverage</td>
<td></td>
<td></td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Loan Amount</td>
<td></td>
<td></td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Lesser of Aggregate Coverage and Loan Amount</td>
<td></td>
<td></td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>

### Examples - Building or Contents Coverage?

**Chef Goodcook loan examples**

**Example 1:** Collateral = GBSA  
(no flood insurance required)

**Example 2:** Collateral = Mortgage on building in SFHA  
(flood insurance required on building only, not the contents)

**Example 3:** Collateral = GBSA and Mortgage on building in SFHA and contents are in the building  
(flood insurance required on building and contents)

GBSA = General Business Security Agreement  
SFHA = Special Flood Hazard Area
HMDA DEFINITIONS

DWELLING
A “dwelling” is a residential structure whether or not it is attached to real property located in the U.S., District of Columbia, or Puerto Rico.
A dwelling includes:
- not only a principal residence but also a vacation home and rental properties, individual condo units, mobile home or manufactured home and “camps”
- multifamily structures like apartment buildings

A dwelling DOES NOT include RV’s and campers or transitory residences like hotels and hospitals, dorms whose occupants have a principal residence elsewhere

HOME PURCHASE LOANS
A home purchase loan is a loan that is both secured by and made for the purpose of purchasing a dwelling. This includes a loan secured by one dwelling that is used to purchase another dwelling.

Mixed-use property
A dwelling-secured loan to purchase property that is primarily sued for residential purposes is a home purchase loan. For example, an apartment building could include a convenience store but the primary property use is residential. Any reasonable standard can be used to determine primary use from square footage to income. This can be done on a case-by-case basis.

Farm loans
A loan to buy property that is primarily for agricultural purposes is not a home purchase loan, even if it includes a dwelling. Any reasonable standard can be used to determine primary use, like the RESPA exemption of 25 acres or more. This can be done on a case-by-case basis.

Commercial and other loans
A home purchase loan does not need to be made solely in the mortgage or consumer loan department. The purchase of an apartment building (that is secured by that or any other dwelling) is reported as a home purchase loan.

Construction and permanent financing
A home purchase loan includes a combined construction/permanent loan; it does not include a construction-only loan which is considered temporary financing.

Second Mortgage down payment
If an institution makes a first mortgage to a purchase and a second mortgage loan to the same purchases to finance all or part of the downpayment, it reports each loan separately.

Multiple-category loans – A loan for purchase as well as home improvement or refinancing is reported as HOME PURCHASE. Purchase trumps ALL categories.
HOME IMPROVEMENT LOANS
For HMDA reporting purposes, a home improvement loan is
- 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
- A non-dwelling secured loan 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 and that is classified by the financial institution as a home improvement loan.

Dwelling secured home improvement loans
Institutions must report under the home improvement loan category any loan OR application for loans secured by a lien on a dwelling if any portion of the loan proceeds would be used to repair, rehabilitate, remodel or improve a dwelling or the real property upon which it is located.

Non-dwelling secured home improvement loans
Non-dwelling secured loans and applications that are for the purpose, in whole or in part, of home improvement continue to be reported only if the institution classifies them as a home improvement loan. This could be done by computer coding, color coded files, or the call report.

Improvements to real property
Home improvement include not only improvements to the dwelling itself, but also improvements to the real property upon which the dwelling is located, for example installing a swimming pool, construction of a garage, or landscaping.

Commercial and other loans
A loan to improve an apartment building through the commercial department is a home improvement loan if it’s secured by a dwelling or if unsecured it is classified as a home improvement loan.

Mixed-use property
A dwelling secured loan to improve property that is for both residential and commercial use is considered home improvement only of the loan proceeds are used primarily to improve the residential portion of the property. Any reasonable standard can be used to determine primary use from square footage to income. This can be done on a case-by-case basis.

Multiple-category loans
If a loan or application qualifies as a home improvement loans AS WELL AS refinancing, it must be reported as HOME IMPROVEMENT. Home improvement TRUMPS refinance. Remember H before R or the loan codes of purchase (1), home improvement (2) and refinance is (3).
REFINANCINGS
A refinancing is a new obligation that satisfies and replaces an existing obligation. If the existing obligation is not satisfied and replaced, not only renewed, modified, extended, or consolidated, the transaction is not a refinancing for HMDA purposes.

NOTE: If a new note is prepared and signed for a HMDA reportable renewal, it IS considered a refinancing for HMDA.

Reportable refinancings
Refinancings are reported under HMDA only if both the existing obligation and the new obligation are secured by liens on dwellings. Lenders may rely on the applicant’s statement about whether or not the loan being refinanced is dwelling-secured.

Refinancings are reported whether or not the institution was the original lender and whether or not the refinancing involves an increase in the loan principal. The purpose of the loan being refinanced is not relevant to determining if the loan qualifies as a refinance. Nor is the borrower’s intended use of any additional cash borrowed relevant to determining a refinancing (HOWEVER the borrower’s intended used of the funds could make the transaction a home improvement loan or a purchase loan).

Refinancing FAQs from the FFIEC
Refinancing --- loan purpose. If an obligation satisfies and replaces another obligation, is the purpose of the replaced obligation relevant to whether the new obligation is a reportable "refinancing" under Regulation C?

Answer: No. The new definition of a reportable refinancing looks only to whether (1) an obligation satisfies and replaces another obligation and (2) each obligation is secured by a dwelling. See 1003.2(k)(2). Thus, for example, a satisfaction and replacement of a loan made for a business purpose is a reportable refinancing if both the new loan and the replaced loan are secured by a dwelling.

Refinancing --- cash out for home improvement. How should a lender code a dwelling-secured loan when the borrower uses the funds both to pay off an existing dwelling-secured loan and to make improvements to a dwelling?

Answer: A dwelling-secured loan that meets the definitions of both "home improvement loan" and "refinancing" should be coded as a "home improvement loan." See comment 1003.2(g)-5. The lender must code the loan as a "home improvement loan" even if the lender does not classify it in the lender's own records as a "home improvement loan." See 1003.2(g)(1).

Refinancing --- line of credit. If a dwelling-secured line of credit satisfies and replaces another dwelling-secured obligation, is the line required to be reported as a "refinancing"?

Answer: No. A dwelling-secured line of credit that satisfies and replaces another dwelling-secured obligation is not required to be reported as a "refinancing," regardless of whether the line is for consumer or business purposes.
Refinancing --- satisfaction of lien. Is the satisfaction of a lien (mortgage) relevant to determining whether an obligation is a reportable refinancing?

**Answer:** No, the satisfaction of a lien is neither necessary nor sufficient to create a reportable refinancing. The credit obligation must be satisfied and replaced; it is not relevant whether the lien is satisfied and replaced. See 1003.2(k)(2)

**Excluded Loans**

Don’t report loans or applications for:

- Unimproved land
- MECA’s – modifications, extensions, and consolidation agreements
- Temporary financing, such as bridge or construction loans
- Loans originated or purchased BY the institution acting as a trustee

**NOTE:** Best practice is to limit temporary financing exclusion to temporary and bridge loans.

**MECAs. Should MECAs (Modification, Extension and Consolidation Agreements) be reported under HMDA as refinancings?**

**Answer:** No. The rule is unchanged: MECAs are not reportable as refinancings under Regulation C. See 67 Fed. Reg. 7221, 7227 (Feb. 15, 2002). The applicable comment was inadvertently omitted when the Commentary was revised in 2002; the comment will be restored when the Commentary is next revised.

**Temporary Financing. When is a loan "temporary financing" such that it is exempt from reporting?**

**Answer:** The regulation lists as examples of temporary financing construction loans and bridge loans. See 1003.4(d)(3). Construction and bridge loans are illustrative, not exclusive, examples of temporary financing. The examples indicate that financing is temporary if it is designed to be replaced by permanent financing of a much longer term. A loan is not temporary financing merely because its term is short. For example, a lender may make a loan with a 1-year term to enable an investor to purchase a home, renovate it, and re-sell it before the term expires. Such a loan must be reported as a home purchase loan. See 1003.2(h).

(****Commonly known as FIX AND FLIP LOANS****)
**Government Monitoring Information**

In an application for a HMDA reportable loan, an institution must collect the applicant’s ethnicity, race and sex as PART of the application process.

This information is not required when the applicant is a legal entity, such as a corporation or partnership, rather than an individual. If the applicant is a sole proprietor YOU MUST STILL COLLECT THE MONITORING INFORMATION. This will mean you also report income of the sole proprietor if it was relied on to make the credit decision.

**Obtaining Government Monitoring Information**

The applicant must be informed that the federal government requests this information in order to monitor compliance with antidiscrimination laws.

The applicant must be informed that if he or she does not provide the information when the application is taken in person, the lender is required to note the date based on visual observation or surname.

Collection of partial information. When collecting government monitoring information (ethnicity, race, sex), must a lender permit an applicant to choose to fill in only one or two, rather than all three, of the fields?

**Answer:** Yes. A lender must permit an applicant to choose to fill in only one or two of the three fields. For example, a Web-based application should not compel the applicant to choose between making selections in each of the three fields and declining to make any selections whatsoever. Unless the applicant clearly indicates the applicant declines to supply any information, the applicant must be given the opportunity to supply any part of the information the applicant chooses.

Reporting of partial information. If an applicant chooses to make selections in one or two, but not all three, fields (ethnicity, race, sex), must the lender report the partial information?

**Answer:** Yes. A lender must report whatever information the applicant supplies, whether partial or complete. For example, if, on an application submitted by mail, an applicant marks a box indicating the applicant does "not wish to furnish" government monitoring information but supplies some or all of the information, the lender must report the information supplied.

Hispanic ethnicity. If an applicant self-identifies as "Hispanic or Latino" under the category of "Ethnicity," what options under "Race" are available?

**Answer:** The applicant should be asked to identify a race or races from among the five choices available. See question below on Definitions of races and Hispanic ethnicity. If a lender is face-to-face with an applicant who (1) has self-identified as "Hispanic or Latino" (or whom the lender has identified as of that ethnicity because the applicant has declined to self-identify) and (2) has not identified a race, the lender must identify whatever race or races the lender believes apply,
based on surname and visual observation. In those circumstances, the lender may not indicate "NA" in the race field. "NA" is used in the race field only if (1) the applicant is not a natural person, (2) the HMDA reporter has purchased, not originated, the loan, or (3) an application taken in 2003 reached final action in 2004 (see comment 1003.4(a)(iv)(B)(3)).

Obtaining the information

- In person application – always request the information by reading the form; if the applicant refuses to provide it make a visual observation and document accordingly
- Telephone applications - always request the information by reading the form; if the applicant refuses to provide it document accordingly
- Mailed applications – the monitoring information should be included on the application. If it wasn’t on the application, send a form letter and monitoring information form. If YOU MEET THE APPLICANT PRIOR TO APPROVAL the information must be requested and the “in-person” requirements apply.
- ALWAYS DOCUMENT how the application was received.
OVERVIEW OF THE 2018 HMDA CHANGES

Most of the provisions of the final rule will take effect on January 1, 2018. Lenders will collect the new information in 2018 and then report this information by March 1, 2019. High-volume originators will file quarterly beginning in 2020. As of February 10, 2016, these resources are available at the implementation link:

http://www.consumerfinance.gov/regulatory-implementation/hmda/

- Executive Summary of the final rule, 5 pages:
- The final rule (797 pages, PDF)
- HMDA key dates timeline, one page
- HMDA Compliance Guide, 109 pages
- Reporting “Not Applicable” reference tool, 8 pages
- Summary of reportable data, 6 pages
- HMDA Institutional Coverage Chart for 2017 & 2018

Types of Institutions Subject to Regulation C

A bank, savings association, or credit union will not be subject to Regulation C in 2017 unless it meets the asset-size, location, federally related, and loan activity tests under the current Regulation C and originates at least 25 home purchase loans in both 2015 and 2016. This change eliminates reporting requirements for low-volume depository institutions.

Effective January 1, 2018, the HMDA rule adopts the following uniform loan-level thresholds which, if met, will subject the institution to Regulation C:

- An institution that originated at least 25 covered closed-end mortgage loans in each of the two preceding calendar years or at least 100 covered open-end lines of credit in each of the two preceding calendar years, and meets other criteria for institutional coverage.
- A bank, savings association, or credit union that originated at least 25 covered closed-end mortgage loans or at least 100 covered open-end lines of credit in each of the two preceding calendar years, and meets the current asset-size, location, federally related, and loan activity tests under the current Regulation C.
- A for-profit lending institution other than a bank, savings association, or credit union that originated at least 25 covered closed-end mortgage loans or at least 100 covered open-end lines of credit in each of the two proceeding calendar years and it satisfies the existing location test.
Types of Transactions Subject to Regulation C

Under the current Regulation C, financial institutions must report information about applications for and originations of closed-end home improvement, home purchase, and refinancing loans. The final HMDA rule generally adopts a dwelling-secured standard for all loans or lines of credit that are for personal, family, or household purposes. More specifically, **effective January 1, 2018**, covered loans will include the following:

- Closed-end consumer-purpose mortgage loans and open-end lines of credit secured by a dwelling.
- Dwelling-secured business-purpose loans and lines of credit, but only if used for home purchase, home improvement or refinancing.
- Home improvement loans secured by a dwelling.
- Covered loans and lines of credit do not include agricultural-purpose or certain other specifically excluded transactions.

Also effective January 1, 2018, financial institutions will be required to collect, record, and report information for **preapproval requests for home purchase loans that were approved but not accepted**. Under the current regulation, such collection is optional. Pre-approval requests for open-end lines of credit, reverse mortgages, and home purchase loans to be secured by multifamily dwellings are excluded.

Specific Information to Collect, Record, and Report

After January 1, 2018, Financial institutions will be required to collect, record, and report additional information about originations of, purchases of, and applications for covered loans. The CFPB explains that this additional information will “enhance the ability to screen for possible fair lending problems, helping both institutions and regulators focus their attention on the riskiest areas where fair lending problems are most likely to exist.”

The HMDA Rule adds the following **new data points**:

- Information about applicants and borrowers, including age, credit score, and debt-to-income and combined debt-to-income ratios.
- Information about the loan process, including whether the application was submitted directly to the institution, whether the loan was, or would have been, initially payable to the institution, and the name of, and results from, the automated underwriting system that was used.
- Information about the property securing the loan, including value and type (e.g., manufactured home).
- Information about the features of the loan, such as total loan costs or total points and fees, origination charges, discount points, lender credits, interest rate, prepayment penalty term, loan term, introductory rate period, and non-amortizing features.
- Certain unique identifiers, such as property address, legal entity identifier for financial institutions, and mortgage originator NMLS identifier.
In an effort to align reporting requirements with well-established data standards and thereby lessen the reporting burden on lenders, the HMDA Rule modifies certain data points, including legal entity identifier, universal loan identifier, loan purpose, preapproval, construction method, occupancy type, loan amount, ethnicity, race, sex, type of purchaser, rate spread, lien status, and reason for denial. Currently under Regulation C, the reporting of the reasons for denial is optional, although some institutions are required to report the reasons under separate requirements.

For data collected in or after 2018, the final rule will require a Covered Institution to report whether it collected information about the applicant’s or borrower’s ethnicity, race, and sex based on visual observation or surname. In addition, Financial institutions must allow applicants to self-identify their own ethnicity and race using disaggregated ethnic and racial subcategories, which will be reported accordingly.

For data collected on or after January 1, 2017, and reported in or after 2018, Financial institutions need no longer directly provide a disclosure statement or a modified loan application register (LAR) to the public upon request. Providing a notice that its disclosure statement and modified LAR are available on the CFPB’s website will be sufficient. In the future, the CFPB will ask the public to provide feedback regarding a balancing test that it will use to determine whether and how HMDA data should be modified prior to its disclosure in order to protect applicant and borrower privacy.

Processes for Reporting and Disclosing Data

In 2018, financial institutions will report data collected in 2017 as required under the current Regulation C, but will use a new web-based electronic submission tool. Starting in 2019, the new required dataset under the final rule will be reported using this new submission tool according to revised procedures which will be developed and made available at http://www.consumerfinance.gov/hmda.

Starting in 2020, in addition to the current requirement to submit HMDA data by March 1 following the calendar year for which data is collected, a Covered Institution must submit reports quarterly if it reported at least 60,000 total applications and/or covered loans (excluding purchased loans) in the preceding calendar year. The first quarterly report will be due by May 30, 2020.

What the HMDA Rule Change Means for Financial institutions

The new HMDA rule requires financial institutions to report more data than is presently required. The new and modified data will likely cause additional scrutiny of lenders, and a proactive approach to these changes is necessary.

The new fields and modified data fields will include much more detail about applicants, borrowers, credit, collateral, loan type, pricing, fees, charges, the originator, and the financial institution. The new and modified data will enable regulators and private parties to analyze a lender’s practices in much greater detail than is currently possible. Analyses of combined data points will also now be possible. For example, the age of the applicant or borrower could
potentially be analyzed in conjunction with pricing, ethnicity, or geographic data in order to identify potential instances of discrimination. Financial institutions will need to consider the impressions HMDA data will create when combined in this manner and make appropriate adjustments to policies, procedures, and pricing considerations.

The additional data requirements concerning loan pricing (e.g., origination charges, discount points, lender credits, and interest rate) are likely to be of great interest to regulators and potential litigants. State regulators may utilize this data in order to identify violations of limitations on fees and charges.

As noted above, most of the changes in Regulation C do not take effect until early 2018. Nevertheless, it is not too early to begin looking at compliance management systems in order to determine how the new and modified data will be collected and added to the institution’s current HMDA data capture and reporting systems. Other issues to consider well in advance of the effective date, include the following:

- System Issues: HMDA data systems will be required to manage significant additional data under the amended rule. An assessment should be made of the capacity of current systems to handle these additional demands. In addition, institutions should identify deficiencies in their existing systems and take corrective action before subjecting those systems to additional demands.

- Staffing: Will current staffing levels be adequate to manage the additional data collection and reporting requirements? Are current training resources adequate to ensure that all employees will be made aware of the changes to policies and procedures necessitated by the amended rule? Internal quality control, compliance, and internal audit functions should begin planning for reviews of the new data, reporting, processes, policies, and procedures.

- Financial institutions should be prepared to conduct self-analysis of their data well before the effective date of the new rule. Consideration should be given to structuring these analyses so that they are protected by applicable privileges.

- Secondary Market Issues: It is reasonable to expect investors to adopt new loan purchase requirements.
SECTION 1071 - SMALL BUSINESS DATA COLLECTION

The CFPB set January 1, 2018, as the effective date of the new HMDA regulations. Potentially, the CFPB could have chosen January 1, 2017, as an effective date. The longer lead time may also be positive news for small business lenders that will be subject to the new Small Business Data Collection rule required by the Dodd-Frank act. Section 1071 of the act requires the CFPB to issue implementing regulations. The Bureau has yet to begin its work on the new rule but some small business lenders have already voiced concerns about the costs of other regulations implemented pursuant to Dodd-Frank. They argue that these costs have already begun to restrict access to small business credit.

A well-timed roll out of the new data collection rule could reduce some of these costs. Having adequate time to develop and implement regulatory compliance procedures in a cost-effective manner will lessen the financial impact to small business lenders. This in turn will allow lenders to minimize the new rule’s impact on credit availability to small businesses.

Once the Small Business Data Collection rule is finalized, small business lenders should be given a sufficient period to adjust to the new requirements, just as the CFPB has done for mortgage lenders with the new HMDA rules. HMDA was enacted in 1975 and lenders have been subject its reporting rules for decades. Yet the increased reporting requirements of the revised rules more than justify a two year lead period.

A similar lead period is just as, if not more important for the small business lenders that will be subject to the new data collection rule. The Dodd-Frank act was enacted just five years ago and requires reporting about small business lending that has never been required before. Lenders will need adequate time to develop the new systems required to meet their reporting obligations.