Best Practices Guide

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Responsible Lending

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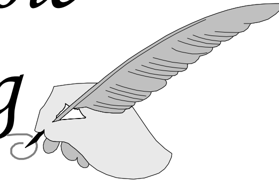

BANKERS ADVISORY RESOURCE GUIDE

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Responsible Lending

Best Practices Guide

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SECTION 1

Bank Secrecy Act / Anti-Money Laundering

Summary

The institution's Bank Secrecy Act/Anti-Money Laundering Compliance program applies to its day-to-day operations regarding its residential mortgage loan products on an interdepartmental level as well as its external branches and operations centers. Compliance is applicable to all employees, agents, affiliates, third party brokers, loan correspondents, closing agents and any other service providers.

The primary objective of this program is to detect and report to the Financial Crimes Enforcement Network (FinCEN) and the appropriate state or federal regulator any suspicious transactions or transactions involving a certain threshold amount of currency, referred to as "covered transactions". The institution's BSA/AML Compliance Program shall be implemented in a manner commensurate to the risk presented to it from its particular business products and services, as well as its size, market, and other considerations.

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Purpose and History of the Bank Secrecy Act

Bank Secrecy Act and related regulations:

1970—Currency and Foreign Transactions Reporting Act (BSA)
1986—Money Laundering Control Act
1988—Anti-Drug Abuse Act (Civil Asset Forfeiture)
1990—Financial Crimes Enforcement Act (FinCEN)
1992—Annunzio-Wylie Act (SAR)
1994—Money Laundering Suppression Act
1998—Money Laundering and Financial Crimes Strategy Act
2001—USA Patriot Act

The Currency and Foreign Transactions Reporting Act of 1970, commonly referred to as the "Bank Secrecy Act" (BSA), requires financial institutions to develop and maintain certain reports and records regarding transactions entered into on behalf of their customers to assist federal enforcement agencies in criminal investigations, most often related to money laundering and terrorist activity. The BSA was designed to help identify the source, volume, and movement of currency and other monetary instruments transported or transmitted into or out of the United States or deposited in financial institutions.

The Financial Crimes Enforcement Network (FinCEN) is the federal agency with the primary responsibility of enforcing the BSA and promulgating related regulations. For institutions that are not subject to FinCEN examination, either through a federal regulator such as the Consumer Finance Protection Bureau or Federal Housing Finance Agency, the Internal Revenue Service or the appropriate state regulator is responsible for enforcing the BSA requirements.

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SECTION 2

E-Sign Act / Electronic Funds Availability Act

E-Sign Act

Summary

On June 30, 2000, Congress enacted the Electronic Signatures in Global and National Commerce Act ("E-Sign Act"), with the purpose of facilitating and encouraging electronic commerce. The E-Sign Act permits the use of electronic records to satisfy any statute, regulation, or rule of law requiring that such information be provide in writing, as long as that the consumer has affirmatively consented to such use, and has not withdrawn their consent. While the Act allows for the use of electronic signatures and records, it does not mandate that institutions or consumers use or accept them.

The majority of the E-Sign provisions became effective on October 1, 2000, and the record of retention requirements became effective on March 1, 2001. For loan guarantees, mortgage insurance, or commitments for such transactions, E-Sign applies only to transactions occurring on or after June 30, 2001. However, existing agreements between a consumer and an institution to deliver information electronically were grandfathered.

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Definitions

"Consumer" is defined as an individual who obtains, through a transaction, products or services which are used primarily for personal, family or household purposes. This includes the legal representative of such an individual.

"Electronic Record" is defined as a contract or other record created, generated, sent, communicated, received or stored by electronic means. Oral communications or a recording of an oral communication does not qualify as an electronic record.

"Electronic Signature" is defined as an electronic sound, symbol, or process attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record. The E-Sign Act does not specify what qualifies as an electronic signature. Rather, that decision is left to the state-based Uniform Electronic Transactions Act (UETA).

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SECTION 3

Fair Lending

Summary

The specific provisions contained in anti-predatory regulations state that it is unlawful and a discriminatory practice for any creditor, its officers, agents or employees to discriminate in granting or fixing the terms of credit against any applicant for credit based on race, creed, color, national origin, age, sex, marital status or disability. Individual laws in the state(s) also prohibit the use of any form of credit application materials which express any limitation, specification or discrimination as to any of the above protected categories. A refusal to consider sources of an applicant's income or to subject an applicant's income to discounting, based on a prohibited basis, is an example of a violation of the law against discrimination.

The institution shall establish processes and procedures to ensure compliance to the Dodd-Frank Wall Street Reform and Consumer Protection Act, state-specific consumer disclosures and federal fair lending laws, including: the Equal Credit Opportunity Act (ECOA), Fair Housing Act (FHAct), Fair Credit Reporting Act (FCRA), Home Owners Equity Protection Act (HOEPA), Flood Disclosure Act, Home Mortgage Disclosure Act (HMDA), Real Estate Settlement Procedures Act (RESPA), Truth in Lending Act (TILA), Mortgage Disclosure Improvement Act (MDIA), Mortgage Acts and Practices- Advertising Rule (MAP Rule), and the Fair and Accurate Transactions Act (FACTA), including the FACTA requirements regarding Red Flags to identify, detect and mitigate identity theft.

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Forms of Discrimination

Discrimination is uncovered by identification of overt evidence of disparate treatment, comparative evidence of disparate treatment and evidence of a disparate impact of a lender's facially neutral policies and procedures. An example of overt evidence of disparate treatment is a policy that explicitly uses protected basis identifiers to determine borrower creditworthiness or eligibility. Comparative disparate treatment may be evidenced in disproportionate underwriting denials, pricing inconsistency, marketing bias or redlining concerning protected groups. Disparate impact may result from a facially neutral policy such as a minimum loan amount requirement that disproportionally excludes protected groups.

SUBTLE	OVERT
Cancel or delayed appointment; Lack of information or follow through	*Refusal to take an application; Steering toward an unsuitable loan*
DISPARATE IMPACT	**DISPARATE TREATMENT**
When an otherwise neutral policy or practice burdens certain persons on a prohibited basis	*Differences in treatment that are not fully explained by legitimate factors*

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Fair Lending Readiness Checklist

1	Does the institution have a written fair lending or anti-predatory lending policy manual?
2	Does the institution have a second review procedure for denied loans?
3	Does the institution have loan programs that provide affordable mortgages based on the borrower profile of the community?
4	Does the institution have loan programs that provide affordable mortgages based on the housing demographics of the lender's marketplace?
5	Does the institution have underwriting guidelines that permit alternative credit documentation such as "utility bills" for applicants who have not built a credit rating?
6	Does the institution have an underwriting policy for grossing up retirement or Social Security income?
7	Does the institution tailor its advertising and promotions to include all demographic characteristics of its lending marketplace?
8	Does the institution offer foreign-language disclosures and other consumer literature for each of the non-English speaking areas of its marketplace?
9	Is there an on-going self-assessment program in place to ensure that the fair lending mission statement and policy are met?
10	Is there a complaint resolution process for consumers?
11	Is there an on-going training program for all employees in consumer loan production areas?
12	Do new employees complete a fair lending or anti-predatory lending training program?
13	Does the loan officer compensation plan adhere to the fair lending guidelines?
14	Is the HMDA-LAR analyzed for incompletion, data-integrity and geocode errors?
15	Are loan programs and credit scoring models reviewed regularly to ensure that underserviced areas are offered suitable loan programs?

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SECTION 4

Flood Act

Summary

The National Flood Insurance Act of 1968 made federally subsidized flood insurance available to owners of improved real estate or mobile homes located in a special flood hazard area if their community participates in the National Flood Insurance Program. The availability of this insurance was motivated by a long history of property damage and loss of life due to flooding. The National Flood Insurance Act of 1968 was revised in 1973, and then again in 1994, in an attempt to correct a lack of participation by lenders and affected borrowers.

The Federal Emergency Management Agency (FEMA) began identifying individual areas as having a high or low flood hazard, and insurance rates were established for structures inside each flood hazard area. The overall goal was to provide flood insurance for structures and their contents in communities that adopt and enforce an ordinance outlining minimal floodplain management standards.

National Flood Insurance Program

The National Flood Insurance Program (NFIP) is administered by a department of FEMA and the Federal Insurance Administration. It allows property owners in participating communities to purchase flood insurance protection from the government. The insurance protects owners against losses from flooding and provides an insurance alternative to disaster assistance in order to meet the escalating costs of repairing flood damage. The National Flood Insurance Program was amended in 1973 to make the purchase of flood insurance mandatory for the protection of property within special flood hazard areas. Under NFIP, lending institutions are prohibited from making, increasing or extending loans secured by improved real estate in a special flood hazard area community, which participates in the National Flood Insurance Program, unless the property is covered by flood insurance. The following properties are eligible for flood insurance under the National Flood Insurance Program:

- Materials for buildings during the course of construction which will be walled and roofed once completed.
- Mobile homes that are affixed to a permanent site such that they resist flotation, collapse and lateral movement.
- Dealer inventory of mobile homes on foundations.
- Condominiums or town houses that are grounded, capable of separate ownership and have legal descriptions.
- High-rise condominiums with common ownership.
- Other types of residential, industrial, commercial and agricultural buildings which include any walled and roofed structure that is principally above the ground and affixed to a permanent site.

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SECTION 5

Home Mortgage Disclosure Act

Summary

The Home Mortgage Disclosure Act (HMDA), Regulation C, was enacted by Congress in 1975 to allow the public to monitor the lending activity of a financial institution in order to determine whether the credit needs of their local communities were being served. The HMDA reporting and disclosure requirements serve to assist in determining whether financial institutions are serving their community housing needs, assisting public offices in distributing investments to attract private investment, identifying possible patterns of discriminatory lending and aid in the enforcement of anti-discrimination statutes.

The Dodd-Frank Act has required the Consumer Financial Protection Bureau (CFPB) to amend the Regulation C requirements of HMDA to include the collection of new information for additional data fields such as applicant age, credit score, originator NMLS identifier and property value. However, as of the date of this publication these amendments have not been finalized.

All banks, savings & loan institutions, credit unions and mortgage lending institutions subject to the Home Mortgage Disclosure Act must prepare and submit a Loan Application Register (LAR). The LAR includes information from certain loans that are purchased, originated, denied, withdrawn, and closed for incompleteness. Denials include loans where counteroffers were not accepted.

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Applicability

The Home Mortgage Disclosure Act requirements apply to both depository and non-depository financial institutions that meet the following criteria:

A bank, savings association, or credit union that:

- On the preceding December 31 had assets in excess of the asset threshold established and published annually by the [Consumer Financial Protection Bureau] for coverage by the Act
- On the preceding December 31, had a home or branch office in an MSA
- In the preceding calendar year, originated at least one home purchase loan (excluding temporary financing such as a construction loan) or refinancing of a home purchase loan, secured by a first lien on a one-to four-family dwelling

SECTION 6

Privacy of Consumer Financial Information: Regulation P

Introduction

The Dodd-Frank Act transferred rulemaking authority for many consumer financial protection laws from various Federal Agencies to the Consumer Financial Protection Bureau (CFPB) effective July 21, 2011. Through Regulation P, the CFPB implemented the consumer privacy provisions of the Gramm-Leach-Bliley Act.

General Requirements of Regulation P

An institution must require all employees, affiliates and service providers to provide notice to customers about the institution's privacy policies and practices. The notice must also describe the conditions under which the institution may disclose nonpublic personal information about consumers to nonaffiliated third parties. Lastly, the institution must give consumers a method to prevent the disclosure of information to nonaffiliated third parties by "opting out" of that disclosure.

An institution is required to comply with Regulation P for information sharing with any of the following:

- Credit Agencies
- Appraisers
- Designated Underwriters
- Mortgage Insurance Companies
- Mortgage Investors
- Document Preparation Companies
- Closing Agents
- Electronic Business to Business Portals
- Outsource Quality Control Firms

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Initial Privacy Notice Requirement

An institution must provide a clear and conspicuous notice that accurately reflects the institution's privacy policies and practices to both customers and consumers. A consumer is an individual who obtains or has obtained a financial product or service from the institution. The notice must be given to a consumer before the institution discloses any nonpublic personal information to a nonaffiliated third party if the disclosure is not authorized. A customer is a consumer who has a continuing relationship with the institution. Notice must be given no later than when the institution establishes a customer relationship. If the institution subsequently transfers the servicing rights to another financial institution, the customer relationship transfers with the servicing rights.

SECTION 7

Red Flags Identity Theft
Under the
Fair and Accurate Credit Transactions Act

Summary

The Red Flags Rules are implemented under the Fair and Accurate Credit Transactions Act of 2003 (FACTA) Sections 114 and 315. The final Red Flags Rules became effective January 1, 2008. Mandatory compliance with the rules was required on November 1, 2008 for depository institutions supervised by the following regulatory agencies:

- Federal Deposit Insurance Corp. (FDIC)
- Federal Reserve Board (FRB)
- Office of the Comptroller of the Currency (OCC)
- Office of Thrift Supervision (OTS)
- National Credit Union Administration (NCUA)

Enforcement of the Red Flags Rules was delayed until May 1, 2009 for entities that fall under the jurisdiction of the Federal Trade Commission (FTC), which includes creditors and State-chartered banks. However, the delay did not affect sections regarding address discrepancies applicable to users of consumer reports or changes of address applicable to credit card issuers.

The Red Flags Rules require all creditors and financial institutions to implement an Identity Theft Prevention Program to detect, prevent, and mitigate identity theft. The Program must reflect the size, structure, and business model of the institution. The institution must update the Program periodically. The Red Flags Rules apply to new or existing covered accounts which may be vulnerable to identity theft.

Under the Red Flags Rules, the institution's executive board must approve the required Program and designate a person to oversee its implementation. The designated person must train staff, oversee audits, complete annual reports, and monitor compliance with the Red Flags Rules.

The Red Flags Rules are published at 72 Fed. Register 63718.

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SECTION 10

Valuation Independence

Summary

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act required the Federal Reserve to amend the appraisal independence rules in Regulation Z of the Truth in Lending Act (TILA). Rulemaking authority for TILA was later transferred from the Federal Reserve Board to the Federal Consumer Financial Protection Bureau (CFPB). On December 22, 2011, the CFPB implemented the Valuation Independence (formerly Appraiser Independence) requirements of Regulation Z found at 12 CFR Part 1026.

Applicability and Definitions

Regulation Z valuation independence rules apply to any consumer credit transaction secured by the consumer's principal dwelling.

"**Appraisal services"** include the services required to perform an appraisal, including defining scope of work, inspecting the property, reviewing necessary and appropriate public and private data sources, developing and rendering an opinion of value, and preparing and submitting the appraisal report.

"Appraisal management company" means any person authorized to recruit, select and retain fee appraisers, contract with fee appraisers to perform appraisal services; manage the process of having an appraisal performed, or review and verify the work of fee appraisers.

"Covered person" means a creditor with respect to a covered transaction or a person that provides settlement services in connection with a covered transaction.

"Covered transaction" means an extension of consumer credit that will be secured by the consumer's principal dwelling.

"Creditor" includes natural persons, business organizations, estates, trusts, and governmental units who *regularly* extend consumer credit and to whom the obligation is initially payable on its face.

"Fee appraiser" means a person who is a state-licensed or state-certified appraiser and receives a fee for performing an appraisal, but who is not an employee or the person engaging the appraiser, or an organization that employs state-licensed or state-certified appraisers and receives a fee for performing appraisals.

"Valuation" is defined as any estimate of value in written/electronic form, other than one produced *solely* by automated model or system.

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