Wednesday, October 21
11:00 am–12:30 pm

211 Bank On It: Trends and Insights in a New Era of Banking Compliance

Gerald Ciejka
Vice President and General Counsel
Westfield Bank

Ian Hecker
Senior Vice President & General Counsel
Middlesex Savings Bank

Edward Seksay
General Counsel
Rockland Trust Company

Copyright © 2009 Association of Corporate Counsel (ACC) and contributing authors.
Reproduction permission requests should be directed to legalresources@acc.com or +1 202.293.4103, ext. 342.

The information in this ACC Annual Meeting material should not be construed as legal advice or legal opinion on specific facts and should not be considered representative of the views of its authors, its sponsors, and/or the ACC. This ACC Annual Meeting material is not intended as a definitive statement on the subject addressed. Rather, it is intended to serve as a tool providing practical advice and references.

Faculty Biographies

Gerald Ciejka
Vice President and General Counsel
Westfield Bank

Ian Hecker

Ian D. Hecker is senior vice president, general counsel and assistant secretary of Natick, Massachusetts-based Middlesex Bancorp, MHC and Middlesex Savings Bank, one of the largest mutually owned banks in the United States with $4.0 billion in assets. He acts as chief legal officer for the holding company and the bank, which offers a broad range of services to businesses and consumers in eastern Massachusetts through 31 retail branches and five loan production offices.

Prior to joining Middlesex he was in-house counsel to Providence-based Citizens Financial Group, Inc. (the holding company for Citizens Bank), and prior to that he was a transactional and tax attorney in private practice.

He is also past Chair and Vice Chair of the American Bankers Association Regional Banks General Counsels Group, and volunteers as a conciliator for the Dedham, Massachusetts District Court through the ACC pro-bono mediation/conciliation program.

He holds a BS with honors from Cornell University, a JD from the University of Connecticut, and an LLM in Taxation from NYU Law School.

Edward Seksay

Edward H. Seksay serves as the general counsel of both Independent Bank Corp. (NASDAQ: INDB), a publicly-traded bank holding company, and Rockland Trust Company, the commercial bank which is its wholly-owned bank subsidiary. Rockland Trust is headquartered in Massachusetts and has approximately $4.6 billion in assets, 71 retail bank branches in Eastern Massachusetts and on Cape Cod, and four Investment Management Group offices in Eastern Massachusetts, on Cape Cod, and in Rhode Island. Mr. Seksay also serves as the Manager of Rockland Trust's New Markets Tax Credit Credit Program, which deploys awards of federal tax credits from the United States Treasury to facilitate lending and economic growth in low-income communities.

Prior to joining Rockland Trust, Mr. Seksay was with the Boston law firm Choate, Hall & Stewart. He worked at Heller, Levin & Seksay, P.C. prior to that.

In 2005 Mr. Seksay was the founding Chairman of the American Bankers Association Regional Banks General Counsels Group.

Copyright © 2009 Association of Corporate Counsel

Mr. Seksay received his Associate Bachelor’s from the College of the Holy Cross in Worcester, Massachusetts. He is a graduate of Suffolk University Law School in Boston.

Copyright © 2009 Association of Corporate Counsel

Highlights of Regulatory Changes to the Truth-in-Lending Act, Home Mortgage Disclosure Act, RESPA and Regulation AA

Gerry Ciejka , General Counsel
Vice President
Westfield Bank
Westfield, Massachusetts

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

Truth-in-Lending Act Changes

- Rules promulgated under the Mortgage Disclosure Improvement Act of 2008
- Effective: Originally, October 1, 2009
  - Accelerated by MDIA to July 30, 2009
- Regulations (Regulation Z) are found at 12 CFR 226
- Highlights of Changes
  - Applies to loans secured by any dwelling – not just principal residence
  - Applies not only refinance loans but to home equity loans as well
  - Requires delivery of early disclosure documents within 3 days of receiving application
  - After disclosure of early disclosure, Lender must wait 7 days before closing the loan
  - Creates an error tolerance for incorrect disclosures
  - If APY is inaccurate by .125% (1/8 of 1%) then you must re-disclose
  - Must wait 3 days between receipt of re-disclosure and closing
  - Lenders are prohibited from charging any fee prior to closing
    - Exception: Credit Report
  - Following statement must be provided in the TIL:
    - "You are not required to complete this agreement merely because you received these disclosures or signed a loan application."

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

Truth-in-Lending Act Changes *(continued)*

oPermits a customer to waive the rescission period and the 7 day period for "personal financial emergencies"

- "personal financial emergencies"
- Example: Foreclosure
- Customer must send letter to lender requesting waiver and state the nature of the emergency

•3 day rescission period – standard business days excluding Sunday's and legal holidays

•Higher priced mortgages

- o New TIL addresses these mortgages –HMDA
- o New restrictions on prepayment penalties
- o New underwriting requirements – ability to repay
- o Must escrow RE taxes and insurance
- o Prohibition on misrepresenting value on consumer's dwelling
- o No influence of appraisers

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

HMDA Changes

•Effective Date: October 1, 2009

•Regulations are found at 12 CFR 203

•Purpose of HMDA: To collect information on loan applications, loans originated and purchased in the institution's geographic area

• Purpose of Amendment: to identify and report "Higher Priced Mortgage Loans"

•Higher Priced Mortgage Loans defined: An APR which is 150 basis points above the prime offer rate for the first lien and 350 basis points above the prime offer rate for subordinate liens.

•FFIEC has set up a rate spread calculator to assist institutions.

- o Internet Address: http:www.ffiec.gov/ratespread/default.aspx

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

REGULATION AA – UNFAIR & DECEPTIVE ACTS & PRACTICES (UDAP) REGULATION Z – Open End Credit

- ***Regulation AA – 12 CFR 227***
  - *New Subpart C- Credit Card Account Practices Rule*
    - *Consumers must be given adequate time to pay – Statement must be delivered 21 days before due date*
    - *Effective Date: August 24, 2009*
  - *Prohibits unfair allocation of payments*
    - *when different APR's apply to different balances must use either:*
      - *High low method: excess payments applied to balance with highest APR and then to balance with next highest APR etc.*
      - *Pro rata method: excess applied to each balance proportionately to overall balance*
  - *Prohibits unfair increases in interest rates*
    - *Requires 45 days notice before increasing the rate due to change in terms, delinquency, default or penalty*

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

REGULATION AA – UNFAIR & DECEPTIVE ACTS & PRACTICES (UDAP) REGULATION Z – Open End Credit

- ***Regulation AA – 12 CFR 227** (continued)*
    - *Exceptions:*
      - *Previously disclosed increases*
      - *Variable rates*
      - *45 days advanced notice*
      - *Delinquency*
      - *Many others*
  - *Prohibits unfair balance computation*
  - *Prohibits charging of security deposits and certain fees*
    - *Cannot be greater than 50% of credit balance*

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

REGULATION AA – UNFAIR & DECEPTIVE ACTS & PRACTICES (UDAP) REGULATION Z – Open End Credit

- ***Regulation Z***
  - *Applies to open ended credit – Not secured by home*
  - *Effective Date: July 1, 2010*
  - *Changes:*
    - *New format for credit card and charge card solicitations and disclosures*
      - *Account opening – key terms in tabular format, greater clarity in disclosing fees*
      - *Model Form G-11*
    - *New periodic statement disclosures*
      - *Itemize charges for different transactions*
      - *Disclose effect of making minimum payments*
      - *Model Forms G-18 (F) – (G)*
    - *Change in terms or interest rate – 45 days notice*
    - *New advertising provisions*

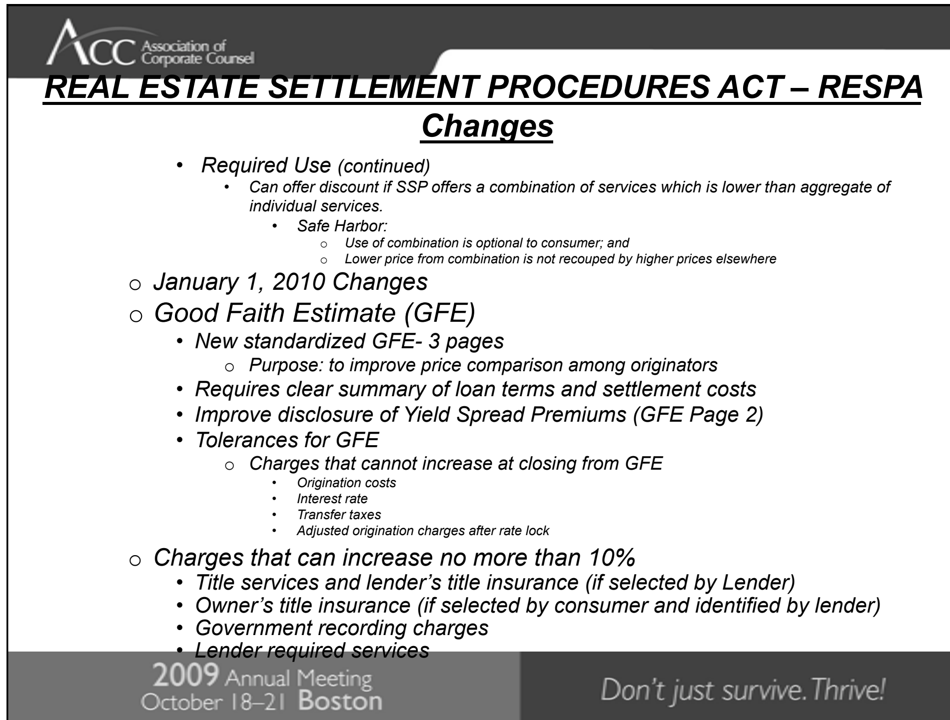
2009 Annual Meeting October 18–21 Boston | Don't just survive. Thrive!

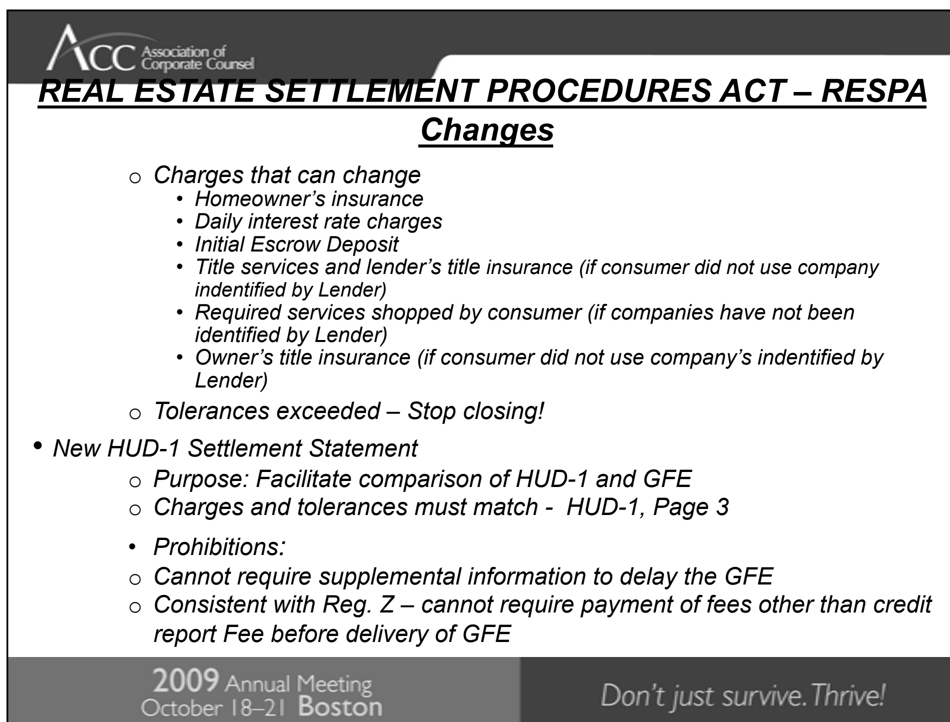
REAL ESTATE SETTLEMENT PROCEDURES ACT – RESPA Changes

- ***REGULATION X – 24 CFR 3500***
  - *Two effective dates:*
    - *January 16, 2009 and January 1, 2010*
  - *January 16, 2009 Changes*
    - *ESIGN – ESIGN is applicable for electronic delivery of disclosures*
    - *Average charge are now permitted*
      - *Settlement Service Provider (SSP) can disclose an average charge on the HUD-1*
        - *Average charge acceptable if borrowers do not pay more than they would be charged if obtained from third parties*
      - *SSP can determine class of transactions for an average charge*
        - *Calculated based on period of time from 30 days to 6 months based on loan type and geographic area*
        - *Must retain documents used to determine average charge for 3 years*
      - *Not permitted where cost is based on price of loan or property value*
    - *Servicing Disclosure Statements*
      - *Servicing Disclosure Notice must be provided at submission of application or within 3 days*
        - *New simplified form*
    - *Required Use*
      - *Section 8 RESPA – Anti-Kick Back*
        - *Fees accepted for referrals in certain situations are prohibited*
      - *Required Use – require consumers to use a certain SSP*

2009 Annual Meeting October 18–21 Boston | Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel


ACC Association of Corporate Counsel
REAL ESTATE SETTLEMENT PROCEDURES ACT – RESPA
Changes
• Required Use (continued)
• Can offer discount if SSP offers a combination of services which is lower than aggregate of individual services.
• Safe Harbor:
o Use of combination is optional to consumer; and
o Lower price from combination is not recouped by higher prices elsewhere
o January 1, 2010 Changes
o Good Faith Estimate (GFE)
• New standardized GFE- 3 pages
o Purpose: to improve price comparison among originators
• Requires clear summary of loan terms and settlement costs
• Improve disclosure of Yield Spread Premiums (GFE Page 2)
• Tolerances for GFE
o Charges that cannot increase at closing from GFE
• Origination costs
• Interest rate
• Transfer taxes
• Adjusted origination charges after rate lock
o Charges that can increase no more than 10%
• Title services and lender's title insurance (if selected by Lender)
• Owner's title insurance (if selected by consumer and identified by lender)
• Government recording charges
• Lender required services
2009 Annual Meeting October 18–21 Boston
Don't just survive. Thrive!


ACC Association of Corporate Counsel
REAL ESTATE SETTLEMENT PROCEDURES ACT – RESPA
Changes
o Charges that can change
• Homeowner's insurance
• Daily interest rate charges
• Initial Escrow Deposit
• Title services and lender's title insurance (if consumer did not use company indentified by Lender)
• Required services shopped by consumer (if companies have not been identified by Lender)
• Owner's title insurance (if consumer did not use company's indentified by Lender)
o Tolerances exceeded – Stop closing!
• New HUD-1 Settlement Statement
o Purpose: Facilitate comparison of HUD-1 and GFE
o Charges and tolerances must match - HUD-1, Page 3
• Prohibitions:
o Cannot require supplemental information to delay the GFE
o Consistent with Reg. Z – cannot require payment of fees other than credit report Fee before delivery of GFE
2009 Annual Meeting October 18–21 Boston
Don't just survive. Thrive!

Recent FCRA Developments
Affiliate Marketing
Identity Theft Red Flag Rules

Ian D. Hecker
Senior Vice President, General Counsel and Assistant Secretary
Middlesex Bancorp, MHC and Middlesex Savings Bank
Natick, Massachusetts

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

Affiliate Marketing under the Fair Credit Reporting Act

2003 FACT Act amended FCRA sec 624 – restricts use of consumer "eligibility information" received from an "affiliate" for marketing "solicitation"

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

Penalties for Violations

A violation of the affiliate marketing rules can result in civil liability of up to $1,000 per violation, plus punitive damages and attorneys fees. Each "solicitation" (email, letter, etc.) could be considered a separate violation resulting in a separate penalty, so as a result the potential for class action damages can be quite large.

2009 Annual Meeting
October 18–21 Boston
Don't just survive. Thrive!

Final Rule – Subpart C to Regulation V Focuses on Use of Information

*A solicitation for marketing purposes is made where: (i) a entity **receives** eligibility information from an affiliate; **and** (ii) either **uses** the information to (a) identify the consumer or type of consumer to receive the solicitation, or (b) establish criteria used to select a consumer to receive a solicitation, or (c) decide which of its products or services to market to the consumer or tailor its solicitation to that consumer, **and** (iii) **as a result of the use** of the eligibility information, the consumer is provided with a solicitation.*

2009 Annual Meeting
October 18–21 Boston
Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

ACC Association of Corporate Counsel

Contrast with Privacy Regs

- *Unlike the privacy regulations, the focus here is not on disclosure but rather on use of the information for marketing purposes*
- *An affiliate can "receive" eligibility information from another affiliate through access to a common database – it need not be shared directly with the affiliate*

2009 Annual Meeting October 18–21 Boston Don't just survive. Thrive!

ACC Association of Corporate Counsel

Regulatory Allowances

- *Constructive sharing is permitted – Smith Co. can provide marketing criteria to Jones Co. and Jones can apply Smith's criteria to Jones' information and mail out Smith's marketing materials for Smith.*
- *Jones can also hire a third party service provider to do this*
  if Smith does not receive the eligibility information.

2009 Annual Meeting October 18–21 Boston Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

Compliance Issues

- *Strict control of access to affiliate databases or use of centralized databases*
- *Ensure that third party marketing providers have policies in place to prevent affiliates from having access – require indemnity*
- *Caution in maintaining opt out databases*
- *Caution with joint Privacy Notices and Opt Out Notices – timing, pre-existing relationship, clarity*
- *Opt out Renewal Notices*

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

Best Way to Avoid Affiliate Marketing Problems

- *Consolidation – the rules restrict sharing between affiliates but not lines of business within one entity.*

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

"Red Flag" Rules
Subpart J to Regulation V

- *Requires the establishment of a written program to detect, prevent and mitigate identity theft.*
- *"Red flag" indicator of possible ID theft*
- *Identity theft: fraud committed or attempted using the identifying information of another person*
- *Focus: fraud prevention*

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

Accounts Effected - "Covered" Accounts

- *consumer transaction accounts*
- *any other account (including business accounts) if it presents a reasonably foreseeable risk to customers or safety and soundness from ID theft – requires risk assessment*
- *Only includes continuing relationships – not single transactions with non-customers*

2009 Annual Meeting October 18–21 Boston

Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

ACC Association of Corporate Counsel

Program Elements

- *Identify red flags indicating ID theft, establish controls to detect red flags, respond appropriately when detected, and periodically update the program*
- *Program can incorporate existing CIP, data security, fraud and privacy programs*
- *Staff must be trained to effectively implement the program*
- *Banks must ensure vendors have controls to detect prevent and mitigate the risk of ID theft with regard to the services they provide*

2009 Annual Meeting October 18–21 Boston Don't just survive. Thrive!

ACC Association of Corporate Counsel

Compliance Issues

- *Some banks did not consider all potential red flags beyond the sample list – did not look at all departments with consumer data in their risk assessment (commercial lending, etc.)*
- *Have not gone through an exam cycle yet so we cannot know how examiners will react to various programs*

2009 Annual Meeting October 18–21 Boston Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

Internet Gambling - The Unlawful Internet Gambling Enforcement Act of 2006

- *Goal: restrict internet gambling by blocking individuals from making payments*
- *Reg GG effective date 1/19/09 with a compliance deadline 12/1/09*
- *Requires banks to screen commercial deposit applicants to determine if they are unlawful internet gambling businesses to keep them out of the U.S. payment system.*

2009 Annual Meeting October 18–21 Boston | Don't just survive. Thrive!

Four Key Items For Bank Compliance with UIGEA Regs

1. Screening commercial customers at account opening
2. Policies/procedures to block prohibited transactions conducted via debit and credit cards
3. Policies/procedures to follow when a commercial account processes restricted transactions
4. New notice requirements for commercial customers

2009 Annual Meeting October 18–21 Boston | Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

ACC Association of Corporate Counsel

Steps at Account Opening

- *for a commercial entity, determine whether applicant poses a minimal risk of operating an internet gambling business – if not a minimal risk, then bank can rely on applicant certification*
- *if applicant is an internet gambling business, then it must provide (1) evidence of legal authority to offer online gaming and (2) third party certification of controls to prevent use by minors and persons from areas where internet gambling is illegal*

ACC Association of Corporate Counsel

Restricting Credit and Debit Card Transactions

- *Because it would be so difficult to monitor individual card transactions, banks can rely on policies/ procedures developed by the card systems (VISA, MasterCard, etc.) to block internet wagering transactions.*
- *Banks must have the card system policies/ procedures in hand by 12/1/09*
- *The expected procedure is for the card systems to assign an online betting merchant code that can be blocked - but it is not known whether the codes will distinguish between legal and illegal gambling*

Copyright © 2009 Association of Corporate Counsel

Bank Policies and Procedures When Restricted Transactions are Discovered

- *When a bank has "actual knowledge" that a commercial account has processed restricted transactions, the bank must exercise its "business judgment" on the extent of action it will take, such as a customer warning, blocking the customer from a payment system, or closing the customer's account.*
- *Banks should have policies/procedures in place to follow when they have "actual knowledge".*

2009 Annual Meeting October 18–21 Boston — Don't just survive. Thrive!

Commercial Account Notice

- *Banks must communicate that restricted transactions are prohibited under UIGEA but there is flexibility in how the notice can be made*

2009 Annual Meeting October 18–21 Boston — Don't just survive. Thrive!

What You Don't Need to Worry About

- No need to monitor payments in or out of the bank to determine if they are internet wagers
- No need to investigate existing business customers
- No need to have policies to block specific payments related to internet gambling

Compliance Issues

- Legitimate businesses may be used as a front for illegal gambling so payment system coding may be inadequate to address the problem – unclear how regulators will react to this.
- Payment system coding may not distinguish between legal and illegal gambling - some banks will block gambling transactions altogether.

Copyright © 2009 Association of Corporate Counsel

Flood Insurance : The Never Ending Story

Financial Regulatory Reform: A New Era in Compliance

Edward H. Seksay, General Counsel
Independent Bank Corp. (NASDAQ: INDB) and
Rockland Trust Company
Rockland, Massachusetts

2009 Annual Meeting
October 18–21 Boston

Don't just survive. Thrive!

New Interagency Questions and Answers Regarding Flood Insurance issued during 2009:

- *77 Q&A issued July 21,2009, 5 new Q&A open for comment until September 21,2009.*

•*There are many ways to violate flood hazard requirements:*

- *failure to timely or properly complete Standard Flood Hazard Determination Form on covered loans;*
- *not giving borrowers notice of flood hazard requirements within the proper timeframe; and,*
- *incorrectly calculating amount of flood insurance required.*

These and other facets of faulty compliance are continuing to give regulators reason to impose civil money penalties.

2009 Annual Meeting
October 18–21 Boston

Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

Civil Monetary Penalties ("CMPs") assessed by the FDIC for flood insurance violations have increased 86% over last year:

- *In the first half of 2009 the FDIC assessed 54 CMPs for flood insurance violations.*
- *The FDIC assessed 29 CMPs during the same period last year, and 34 during the first half of 2007.*

2009 Annual Meeting October 18–21 Boston — Don't just survive. Thrive!

Compliance with Federal Flood Insurance Laws and Regulations

Applies whenever you make, increase, renew, or extend a loan that is secured by a building located in a flood zone:

1)Applies whenever you are taking a security interest in a building including "abundance of caution" collateral, storage sheds, etc.

2)Provide Flood Insurance Notice at least 10 days before closing

- *Signed copy must be obtained and retained in loan file*
- *Notice required even when relying on a previous flood determination*

2009 Annual Meeting October 18–21 Boston — Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

Flood insurance coverage on contents:

- *Required if you are taking a security interest in contents,* ***and***
- *Contents are housed in a building located in a flood zone,* ***and***
- *You are taking a security interest in that building as well as the contents.*

Minimum amount of flood insurance required:

- *Lesser of the …*
  - *replacement cost of the secured collateral;*
  - *amount of all loans secured by the collateral; or*
  - *maximum amount available under the NFIP:*
    - *Commercial building - $500,000*
    - *Residential building - $250,000*
    - *Commercial contents - $500,000*

2009 Annual Meeting October 18–21 Boston Don't just survive. Thrive!

Adequate flood insurance coverage can only be evidenced by a copy of the policy declarations page ***-or-*** *the flood insurance application accompanied by a receipt for the payment in full of the first year's premium.*

- *Binders or certificates of insurance are not accepted by the NFIP.*
- *Multiple buildings require multiple policies.*

The flood zone on the policy ***must*** *match the flood zone identified on the Standard Flood Hazard Determination Form.*

2009 Annual Meeting October 18–21 Boston Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

Financial Regulatory Reform: The Obama Administration Proposal

- *Federal Reserve as systemic risk advisor*
- *Merge Office of Thrift Supervision into Office of the Comptroller of the Currency*
- *A new regulator: the Consumer Financial Protection Agency*
  - *broad authority to regulate providers of consumer financial services and products*
  - *covers banks and non-banks*
  - *supervisory and examination powers*
  - *no preemption: states can impose more stringent requirements*

2009 Annual Meeting October 18–21 Boston — Don't just survive. Thrive!

Copyright © 2009 Association of Corporate Counsel

Home Mortgage Disclosure Act Materials

Part A – Screen Shot of Rate Spread Calculator

Part B – Final Rule

Copyright © 2009 Association of Corporate Counsel

Part A – Screen Shot of Rate Spread Calculator

Copyright © 2009 Association of Corporate Counsel

HMDA Rate Spread Calculator - Windows Internet Explorer provided by Westfield Bank

http://www.ffiec.gov/ratespread/default.aspx

File Edit View Favorites Tools Help

HMDA Rate Spread Calculator

FFIEC FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL
Promoting uniformity and consistency in the supervision of financial institutions

FFIEC Rate Spread Calculator

Application Date	Calculator to Use
October 1, 2009 or after	New Calculator
Before October 1, 2009	Old Calculator
Before October 1, 2009 but Action Taken (loan closed) on or after January 1, 2010	New Calculator

Direct Link to OLD CALCULATOR:
http://www.ffiec.gov/ratespread/oldcalc.aspx

Direct Link to NEW CALCULATOR and "Average Prime Offer Rates" Tables:
http://www.ffiec.gov/ratespread/newcalc.aspx

NOTE: You can save the above links to your browser "Favorites" for convenient access to the appropriate calculator once you are familiar with when to use each calculator.

Date + time : Tuesday, August 18, 2009 2:51:08 PM
Computer name : 1937B02AUD003 User name : njv Operating System : Windows NT

Part B – Final Rule

Copyright © 2009 Association of Corporate Counsel

[Federal Register: October 24, 2008 (Volume 73, Number 207)]
[Rules and Regulations]
[Page 63329-63338]
From the Federal Register Online via GPO Access [wais.access.gpo.gov]
[DOCID:fr24oc08-1]

===
Rules and Regulations
Federal Register
____

This section of the FEDERAL REGISTER contains regulatory documents having general applicability and legal effect, most of which are keyed to and codified in the Code of Federal Regulations, which is published under 50 titles pursuant to 44 U.S.C. 1510.

The Code of Federal Regulations is sold by the Superintendent of Documents. Prices of new books are listed in the first FEDERAL REGISTER issue of each week.

===

[[Page 63329]]

FEDERAL RESERVE SYSTEM

12 CFR Part 203

[Regulation C; Docket No. R-1321]

Home Mortgage Disclosure

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule; official staff interpretation.

SUMMARY: The Board is publishing final rules to amend Regulation C (Home Mortgage Disclosure) to revise the rules for reporting price information on higher-priced loans. The rules are being conformed to the definition of ``higher-priced mortgage loan'' adopted by the Board under Regulation Z (Truth in Lending) in July of 2008. Since 2004, Regulation C has required lenders to collect and report the spread between the annual percentage rate (APR) on a loan and the yield on Treasury securities of comparable maturity if the spread is equal to or greater than 3.0 percentage points for a first-lien loan (or 5.0 percentage points for a subordinate-lien loan). Under the final rule, a lender will report the spread between the loan's APR and a survey-based estimate of APRs currently offered on prime mortgage loans of a comparable type if the spread is equal to or greater than 1.5 percentage points for a first-lien loan (or 3.5 percentage points for a subordinate-lien loan).

Copyright © 2009 Association of Corporate Counsel

DATES: The final rule is effective October 1, 2009. Compliance is mandatory for loan applications taken on and after that date and for loans that close on and after January 1, 2010 (regardless of their application dates).

FOR FURTHER INFORMATION CONTACT: John C. Wood, Counsel, or Paul Mondor, Senior Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452-2412 or (202) 452-3667. For users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263-4869.

SUPPLEMENTARY INFORMATION:

I. Background on HMDA and Regulation C

The Home Mortgage Disclosure Act (HMDA), enacted in 1975, requires depository and certain for-profit, nondepository institutions to collect, report to regulators, and disclose to the public data about originations and purchases of home mortgage loans (home purchase and refinancing) and home improvement loans, as well as loan applications that do not result in originations (for example, applications that are denied or withdrawn). HMDA data can be used to help determine whether institutions are serving the housing needs of their communities. The data help public officials target public investment to attract private investment where it is needed. HMDA data also assist in identifying possible discriminatory lending patterns and in enforcing antidiscrimination statutes.

The Board's Regulation C implements HMDA. The data reported under Regulation C include, among other items, application date; loan type, purpose, and amount; the property location and type; the race, ethnicity, sex, and annual income of the loan applicant; the action taken on the loan application (approved, denied, withdrawn, etc.), and the date of that action; whether a loan is covered by the Home Ownership and Equity Protection Act (HOEPA); lien status (first lien, subordinate lien, or unsecured); and certain loan price information.\1\

\1\ Institutions report these data to their supervisory agencies on an application-by-application basis using a register format. Institutions must make their loan/application registers available to the public, with certain fields redacted to preserve applicants' privacy. The Federal Financial Institutions Examination Council (FFIEC), on behalf of the supervisory agencies, compiles the reported data and prepares an individual disclosure statement for each institution, aggregate reports for all covered institutions in each metropolitan area, and other reports. These disclosure statements and reports are also available to the public.

Regulation C's requirement to report loan price information took effect beginning with the collection of data for calendar year 2004. 67 FR 7222 (Feb. 15, 2002); 67 FR 30771 (May 8, 2002); and 67 FR 43218 (June 27, 2002). Institutions must report the difference between a loan's APR and the yield on Treasury securities of comparable maturity if that difference is equal to or greater than 3.0 percentage points for a first-lien loan, or 5.0 percentage points for a subordinate-lien loan. This difference is known as the rate spread. The Treasury yield used is as of the 15th day of the month most closely preceding the date the loan's interest rate was set by the institution for the final time before closing (rate-lock date). The Board provides Treasury yields for

Copyright © 2009 Association of Corporate Counsel

various maturities, via the Federal Financial Institutions Examination Council (FFIEC) Web site, to assist institutions in calculating the rate spread.

II. Summary of Final Rule

On July 30, 2008, the Board published a proposed rule that would amend Regulation C's requirement to report price information. 73 FR 44189 (July 30, 2008). The Board is publishing final amendments to Regulation C to adopt a method for determining when the rate spread is reported that is similar in concept to Regulation C's current method but different in the particulars. The final rule, like the current rule, sets a threshold above a market rate to trigger reporting. But the market rate the Board is adopting is different, and therefore so is the threshold. Instead of yields on Treasury securities of comparable maturity, the rule uses a survey-based estimate of market APRs for the lowest-risk prime mortgages, referred to as the ``average prime offer rate,'' for comparable types of transactions.

The survey the Board will rely on for the foreseeable future is the Primary Mortgage Market Survey[supreg] (PMMS) conducted by Freddie Mac. The Board will conduct its own survey if it becomes appropriate or necessary to do so. The reporting threshold is set at 1.5 percentage points above the applicable average prime offer rate for first-lien loans, and 3.5 points above the applicable average prime offer rate for subordinate-lien loans. The lender reports the difference between the transaction's APR and the average prime offer rate on a comparable type of transaction if the difference is equal to or greater than the threshold.

The final rule will provide pricing data on higher-priced mortgage loans reported under Regulation C that are

[[Page 63330]]

more consistent with prevailing mortgage market pricing over time, which will make data reporting more predictable. The rule also will facilitate regulatory compliance by conforming the test for rate spread reporting under Regulation C to the definition of higher-priced mortgage loans under Regulation Z.

III. Reasons for Improving HMDA Rate Spread Reporting

When the Board first adopted Regulation C's rate spread reporting requirement, the objective was to cover substantially all of the subprime mortgage market while generally avoiding coverage of prime loans. Since the requirement went into effect, HMDA reporters and others have on various occasions identified shortcomings of the Treasury yield benchmark. In July of 2008, the Board proposed changing the rate spread reporting benchmark. The proposed new benchmark was a market-based estimated average of prime mortgage rates, derived from the PMMS. A lender would report the spread between the loan's APR and the survey-based estimate of average APRs currently offered on prime mortgage loans of a comparable type if the spread is equal to or greater than 1.5 percentage points for a first-lien loan (or 3.5 percentage points for a subordinate-lien loan). This approach would track the pricing-based coverage test for the new protections for higher-priced mortgage loans under Regulation Z, adopted by the Board in July of 2008. 73 FR 44522 (July 30, 2008).

A. Drawbacks of Using Treasury Security Yields

Copyright © 2009 Association of Corporate Counsel

Although there are advantages to using Treasury yields to set the threshold for reporting price information, there also are significant drawbacks. Advantages include the facts that Treasuries are traded in a highly liquid market, Treasury yield data are published for many different maturities and can easily be calculated for other maturities, and the integrity of published yields is not subject to question. For these reasons, Treasuries are also commonly used in federal statutes for benchmarking purposes.

As recent events have highlighted, using Treasury yields to set the APR threshold for HMDA rate spread reporting has two major disadvantages. The most significant disadvantage is that the spread between Treasuries and mortgage rates changes in both the short term and in the long term. Moreover, the truly comparable Treasury security for a given mortgage loan can be difficult to determine accurately.

The Treasury-mortgage spread can change for at least three different reasons. First, credit risk may change on mortgages, even for the highest-quality borrowers. For example, credit risk may increase during economic downturns. Second, competition for prime borrowers can increase, tightening spreads, or decrease, allowing lenders to charge wider spreads. Third, movements in financial markets can affect Treasury yields but have no effect on lenders' cost of funds or, therefore, on mortgage rates. For example, Treasury yields fall disproportionately more than mortgage rates during a ``flight to quality.''

Recent events illustrate how much the Treasury-mortgage spread can swing. The spread averaged about 170 basis points in 2007 but increased to an average of about 220 basis points in the first half of 2008. In addition, the spread was highly volatile in this period, swinging as much as 25 basis points in a week. Thus, the spread may vary significantly from time to time, and long-term predictions of future spreads are highly uncertain. Such changes in the Treasury-mortgage spread mean that rate spreads for loans with identical credit risk are reported in some periods but not in others, contrary to the objective of consistent and predictable coverage over time.

Adverse consequences of volatility in the spread between mortgage rates and Treasuries could be reduced simply by setting the regulatory threshold at a high enough level to ensure exclusion of all prime loans. But a threshold high enough to accomplish this objective would likely fail to meet another, equally important objective of covering essentially all of the subprime market. Instead, the Board is adopting a benchmark index that more closely follows mortgage market rates and therefore should make reporting more consistent and predictable.

The second major disadvantage of using Treasury yields to set the threshold is that the truly comparable Treasury security for a given mortgage loan can be difficult to determine accurately. Regulation C approximates the ``comparable'' Treasury security on the basis of maturity: a loan is matched to a Treasury security with the same contract term to maturity. For example, the regulation matches a 30-year mortgage loan to a 30-year Treasury security. This method, however, does not account for the fact that very few loans reach their full maturity, and it causes significant distortions when the yield curve changes shape.\2\ These distortions can bias coverage, sometimes in unpredictable ways, and consequently might influence the preferences of lenders to offer certain loan products in certain environments.

\2\ Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner (2006), ``Higher-Priced Home Lending and the 2005 HMDA Data,'' Federal Reserve Bulletin, vol. 92 (September 8), pp. A123-66.

Copyright © 2009 Association of Corporate Counsel

For example, variable-rate mortgage loans typically are priced based on expected maturities that are closer to the loans' initial, fixed-rate periods than to their full, nominal terms. Especially in a sharply rising yield curve environment, lenders may be biased toward offering such products because their pricing terms are established by reference to their expected actual maturities and, therefore, would tend to remain well below a set threshold over yields on Treasury securities that match their much longer, nominal maturities. By adopting benchmarks that more closely track mortgage market rates and matching loans to benchmarks by product type, rather than solely by contractual term to maturity, the Board expects to reduce such disparities between mortgage loan pricing and the applicable benchmarks because those benchmarks already will reflect the expected maturities on which lenders base their pricing.

B. Reasons for Following the Regulation Z Final Rule

As noted above, the Board's objective in setting the rate spread reporting threshold has been to cover subprime mortgages and generally to avoid covering prime mortgages. The same purpose underlies the definition of ``higher-priced mortgage loan'' that the Board adopted under Regulation Z. For the reasons discussed above, the Board believes the definition adopted under Regulation Z, when applied to Regulation C, will better achieve this purpose and ensure more consistent and more useful HMDA data. Moreover, using the same definition in both Regulation Z and Regulation C will reduce compliance burdens.

IV. The Board's Final Rule

A. Public Comment on the Proposed Rule

The Board requested comment on (1) the proposal to change the reporting benchmark from Treasury yields to average prime offer rates; (2) the Board's plan to use the Freddie Mac PMMS to estimate average prime offer rates, including comment on whether there are more appropriate sources of data; (3)

[[Page 63331]]

the method the Board proposed to use to derive average prime offer rates from the PMMS data, which was published as Attachment I to the proposal; (4) the proposed 1.5 and 3.5 percentage point thresholds; (5) the proposed timing for rate spread determination (rate-lock date, with weekly updating of the average prime offer rate benchmarks); (6) the proposed implementation date of the amendments; and (7) the costs and benefits of the proposal generally.

The Board received 21 comment letters on the proposal. Commenters were virtually unanimous in support of changing the reporting benchmark from Treasury yields to average prime offer rates, as well as the use of the PMMS to estimate average prime offer rates. Industry commenters largely agreed that use of the same test under Regulations C and Z would reduce regulatory burden. Nearly all commenters agreed that the proposed changes would result in more accurate HMDA data. And most commenters agreed with the proposed thresholds over average prime offer rates of 1.5 and 3.5 percentage points for first-lien and second-lien loans, respectively. Finally, the majority of commenters favored, or did not object to, the continued use of the rate-lock date as the best time for rate spread determinations. Some industry commenters expressed concern that weekly updates of average prime offer rates would increase

Copyright © 2009 Association of Corporate Counsel

burdens on HMDA reporters. These commenters were not opposed to weekly updating, per se, but rather as an additional aspect of the substantial, overall burden arising from the proposal.

Industry commenters strongly opposed the proposed implementation date of January 1, 2009. A joint comment letter filed by five industry trade associations argued that their members would be unable to implement all the necessary systems changes and conduct necessary staff training by the proposed effective date. Industry commenters also raised various issues relating to timing and calculation methodology under the Board's proposal for deriving average prime offer rates from the PMMS data. The timing and methodology issues are discussed below, in parts IV.D and IV.E, respectively. The implementation date is discussed in part V.

B. Rates From the Prime Mortgage Market

To address the principal drawbacks of Treasury security yields, discussed above, the Board proposed a rule that relies instead on benchmarks that more closely track rates in the prime mortgage market. The Board is adopting the use of average prime offer rates substantially as proposed. The final rule defines an ``average prime offer rate'' as an APR derived from average interest rates, points, and other pricing terms offered by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. Comparing a transaction's APR to this average prime offer rate (defined as an APR), rather than to an average offered contract interest rate, should make reporting more accurate and consistent because both rates, rather than just one of them, will reflect the total cost of credit that an APR represents. If the spread between a loan's APR and the average prime offer rate for a comparable transaction is equal to or greater than 1.5 percentage points for a first-lien loan, or 3.5 percentage points for a subordinate-lien loan, the lender must report the difference under Regulation C. The basis for selecting these thresholds is explained further below, in part IV.C.

To facilitate compliance, the final rule and commentary provide that the Board will derive average prime offer rates from survey data according to a methodology it will make publicly available, and the Board will publish these rates in two tables (one each for variable-rate and non-variable-rate loans) on the FFIEC's Web site on at least a weekly basis. The methodology published as Attachment I to this Federal Register notice, which will appear together with the tables on the Web site, provides that comparable transactions are determined by the initial, fixed-rate period for variable-rate loans and by term to maturity for non-variable rate loans. The tables will set forth average prime offer rates for each of 14 products (six variable-rate and eight non-variable-rate loans), and the methodology provides assignment rules for all other initial, fixed-rate periods or terms to maturity, as applicable. The methodology will remain on the Web site along with the tables. Should it be revised in the future, the Board will republish it as revised at least several months before such revisions become effective.

As noted above, the survey the Board intends to use for the foreseeable future is Freddie Mac's PMMS, which contains weekly average rates and points offered by a representative sample of creditors to prime borrowers seeking a first-lien, conventional, conforming mortgage and who would have at least 20 percent equity. The PMMS contains pricing data for four types of transactions: ``1-year ARM,'' ``5/1-year ARM,'' ``30-year fixed,'' and ``15-year fixed.'' PMMS pricing data for ARMs are based on ARMs that adjust according to the yield on one-year Treasury securities; the pricing data include the margin and the

Copyright © 2009 Association of Corporate Counsel

initial rate. These data are updated every week and are published on Freddie Mac's Web site (see http://www.freddiemac.com/dlink/html/PMMS/display/PMMSOutputYr.jsp).

The Board will use the pricing terms from the PMMS, such as interest rate and points, to calculate an APR (consistent with Regulation Z, 12 CFR 226.22) for each of the four types of transactions that the PMMS reports. These APRs will be the average prime offer rates for transactions of those types. The Board will derive APRs for other types of transactions from the loan pricing terms available in the survey. The method of derivation the Board will use is being published as Attachment I to this Federal Register notice and will be published on the FFIEC's Web site along with the tables of average prime offer rates.

The methodology statement in Attachment I will be implemented substantially as it was proposed, except that some further details have been added for additional clarity and to address some technical issues raised by commenters. These technical issues are discussed below, in parts IV.E and IV.F. The Board will continue to review the methodology statement following publication of this Federal Register notice, to ensure that it is as clear and useable as possible, and may make further revisions before it is published on the FFIEC's Web site along with the tables of average prime offer rates. The Board expects to publish both the tables and the methodology statement, as it will be implemented when this final rule becomes effective on October 1, 2009, on the FFIEC's Web site by early January of 2009.

C. Thresholds for Rate Spread Reporting

The Board is adopting thresholds of 1.5 percentage points above the average prime offer rate for a comparable transaction for first-lien loans and 3.5 percentage points for second-lien loans, as proposed. These thresholds are the same as those adopted under Regulation Z's definition of ``higher-priced mortgage loan'' in the July final rule. 73 FR 44522 (July 30, 2008).

As discussed above, the rate spread reporting requirement was intended to cover the subprime market and generally exclude the prime market, and in the face of uncertainty it is appropriate to err on the side of covering somewhat more than the subprime market. Based on available data, it appears that the existing thresholds capture all of the subprime

[[Page 63332]]

market and a portion of the alt-A market. Based also on available data, the Board believes that the thresholds it is adopting also will cover all of the subprime market and a portion of the alt-A market. The Board considered loan-level origination data for the period 2004 to 2007 for subprime and alt-A securitized pools. The proprietary source of these data is FirstAmerican Loan Performance.\3\ The Board also ascertained from a proprietary database of mostly government-backed and prime loans (McDash Analytics) that coverage of the prime market during the first three quarters of 2007 at these thresholds would have been very limited. The Board recognizes that the recent mortgage market disruption began at the end of this period, but it is the latest period the Board has been able to study in this database.

\3\ Annual percentage rates were estimated from the contract rates in these data using formulas derived from a separate proprietary database of subprime loans that collects contract rates,

Copyright © 2009 Association of Corporate Counsel

points, and annual percentage rates. This separate database, which contains data on the loan originations of eight subprime mortgage lenders, is maintained by the Financial Services Research Program at George Washington University.

The Board is adopting a threshold for subordinate-lien loans of 3.5 percentage points. This is consistent with the existing rule under Regulation C, which sets the threshold over Treasury yields for these loans two percentage points above the threshold for first-lien loans. See 12 CFR 203.4(a)(12). The Board recognizes that it would be preferable to set a threshold for second-lien loans above a measure of market rates for second-lien loans, but a suitable measure of this kind does not appear to exist. Although data are very limited, the Board believes it remains appropriate to apply the same difference of two percentage points to the thresholds above market mortgage rates. Commenters explicitly endorsed, or at least raised no objection to, this approach.

Some commenters raised issues relating to the scope of coverage for ``higher-priced mortgage loans'' under Regulation Z. For example, commenters suggested either exempting from coverage, or providing higher thresholds for, certain loan product types, such as loans exceeding the Fannie Mae and Freddie Mac maximum loan size (jumbo loans) and loans under Federal Housing Administration (FHA) programs. Suggestions relating to the scope of coverage were considered and addressed in the Board's final rule under Regulation Z. 73 FR 44522, 44536-44537; 44539 (July 30, 2008).

The Board remains aware that the spread between prime conforming and prime jumbo loans currently is unusually wide. If this spread remains wider than it historically has been when the final rule takes effect, the rule will cover some prime jumbo loans. While covering prime jumbo loans is not the Board's objective, the Board does not believe that it should set the threshold at a higher level to avoid what may be only temporary coverage of these loans relative to the long-time horizon for this rule. The Board also continues to believe that establishing various thresholds for various different product types would make the regulation inordinately complicated and subject it to frequent revision, which would not be in the interests of those who report HMDA data or those who use them. The Board will continue to monitor the overall market and relative pricing spreads between submarkets to ensure that the benefits of simplicity and stability offered by the rule as adopted continue to outweigh the disadvantages of sometimes inadvertently capturing rate spread data on loans to which the rule is not intended to apply.

D. Timing of Determining the Rate Spread

When Benchmarks Become Effective

Regulation C currently determines the Treasury yield benchmark as of the 15th of the month before the rate-lock date. This rule will determine the applicable benchmark for a transaction more frequently. The final rule requires a creditor to use the most recently available average prime offer rate as of the rate-lock date. As the PMMS is updated weekly, the Board will also update average prime offer rates weekly. The Board expects that using a more current benchmark will improve reporting accuracy without significantly increasing regulatory burden.

To address concerns raised by industry commenters over their ability to apply timely the most recent benchmarks, the final rule includes additional explanation, in appendix A, as to the meaning of

Copyright © 2009 Association of Corporate Counsel

``most recently available.'' The Board generally will update the tables each Friday morning, but the new benchmarks will be dated to indicate when they are effective, and the effective date will be subsequent to the date of publication. The ``most recently available'' average prime offer rates are those most recently effective as of the date the rate is set. The Board's intention is that updates to the tables made each Friday will be effective the following Monday, as reflected in the methodology statement published as Attachment I to this Federal Register notice. For example, new average prime offer rates applicable during the week of Monday through Sunday, October 12-18, 2009, would be posted on the FFIEC's Web site on Friday, October 9, but they would be dated October 12. Loans that are locked in on October 9 through 11, including loans locked in on October 9 after the benchmarks dated October 12 have been posted, would be compared to the average prime offer rates for comparable transactions dated October 5 (assuming the loan application was made on or after October 1). In unusual situations, such as public holidays falling on a Friday, the Board may not publish new benchmarks on that day. Whenever new benchmarks are published, however, they always will be dated subsequent to the date of publication, so that lenders will not be required to apply new benchmarks the same day they are published. For consistency's sake, lenders may not apply new benchmarks before the Monday following publication, even if their systems are capable of applying the new benchmarks earlier.

When the Rate Is Set

Industry commenters suggested that the time the rate is set should be flexible enough to accommodate differing methods of locking in rates used by mortgage lenders. Specifically, they stated that some lenders employ a ``base rate plus rate adjusters'' system, whereby a lender may lock in the ``base rate'' as well as various ``rate adjusters'' that may or may not apply, depending on loan factors to be determined subsequently (such as an appraisal that results in a different loan-to-value ratio than previously expected). Thus, although the ``base rate'' has been locked in on a certain date, and all potentially applicable ``rate adjusters'' also may be locked in, the rate still may change afterwards if the applicability of any ``rate adjuster'' changes.

The Board's intent was not to alter the current meaning of when the rate is set for the final time before closing. If a loan's rate may change, for any reason, then it has not yet been set for the final time before closing. Accordingly, the Board's final rule leaves the relevant discussion of when the rate is set, in appendix A, unchanged in this regard.

E. Determination of ``Comparable Transaction''

Assignment Rules

The proposal stated that the Board's tables of average prime offer rates would indicate how to determine what

[[Page 63333]]

constitutes a ``comparable transaction'' for purposes of matching a mortgage loan's APR to the appropriate benchmark. Some commenters interpreted the methodology statement's assignment rules as matching loans for which the tables contain no exact match to the benchmark of the next longest term. This interpretation was not the Board's intent.

The Board's intent was to preserve the assignment rules currently applicable under HMDA. Under those rules, a loan with a term not represented among the Treasury security terms listed in the table matches to the Treasury security with the term closest to the loan's

Copyright © 2009 Association of Corporate Counsel

term, and when a loan has a term exactly halfway between two Treasury security terms it matches to the Treasury security with the shorter of the two terms. The methodology statement that is published with this final rule (Attachment I to this Federal Register notice) and that will accompany the tables on the FFIEC's Web site is revised to clarify the correct assignment rules for the new tables of average prime offer rates, which track the existing assignment rules for the existing table of Treasury yields.

Interpolation Methodology

Industry commenters also recommended a revision to the proposed method for interpolating estimated APRs for loan products for which PMMS data are not available. The methodology requires calculating ``Treasury spreads'' (the difference between the PMMS-reported rates and corresponding Treasury yields) as a first step towards estimating rates for other products, before ultimately calculating APRs for those other products. The Board proposed calculating the necessary Treasury spreads as the PMMS-reported initial rates for one- and five-year variable-rate loans minus the average yields on one- and five-year Treasury securities, respectively. These one- and five-year spreads are used as inputs in estimating APRs for loan products not included in the PMMS survey. These commenters suggested instead calculating a ``relative'' spread by dividing the PMMS-reported rates by the corresponding Treasury yields. In structuring the calculation of Treasury spreads as absolute rather than proportional, the Board intended to mirror the manner in which the mortgage industry builds incremental prepayment and credit risk into loan pricing. For this reason, the Board is retaining the calculation as proposed.

Unusual Loan Products

Some commenters sought clarification on how to determine comparable transactions for certain unusual loan product types, such as step-rate loans, loans with balloon payments, and loans with temporary, interest-only payment terms. The Board believes that the rule as structured addresses all loan product types. Regulation Z already provides guidance for the calculation of APRs on loans with unusual payment terms. The APR calculated and disclosed according to those rules is to be compared to the average prime offer rate for comparable transactions. If the APR is higher than it would be in the absence of any unusual payment terms, the Board sees no reason for establishing special rules for such products under the new rate spread reporting test. Determination of ``comparable transactions'' depends solely on two factors: (i) Whether the loan is variable-rate or not; and (ii) the length of the initial, fixed-rate period (if variable-rate) or the term to maturity (if non-variable-rate).

F. Technical Issues

APR Calculation--Payment Schedule Assumptions

In the methodology statement for deriving and estimating APRs from PMMS data the Board included an assumption that monthly payments would be rounded to whole cents, thus likely requiring an odd final payment amount. The Board's intent was to track the way mortgage lenders actually calculate APRs on their transactions. But rounding payment amounts to whole cents necessarily requires having a loan amount, which is not the case for the hypothetical transaction underlying the PMMS data. Therefore the Board is revising the methodology statement to provide that the calculation should assume all payments are equal, even if this results in payment amounts that include fractions of cents. This revision applies only to the calculation of hypothetical APRs from PMMS data for use as average prime offer rates; it does not affect lenders' ability to calculate APRs for disclosure purposes using

Copyright © 2009 Association of Corporate Counsel

payment amounts in whole cents, pursuant to Regulation Z. See 12 CFR 226.17(c)(3)(i).

HOEPA Status Reporting--Sec. 203.4(a)(13)

Although the Board did not propose to revise Sec. 203.4(a)(13), some commenters pointed out that, as a result of the amendments to Regulation Z in the Board's July 30, 2008 final rule, the language in Sec. 203.4(a)(13) now could be considered ambiguous. Section 203.4(a)(13) requires the reporting of ``[w]hether the loan is subject to the Home Ownership and Equity Protection Act of 1994.'' Until the July 30, 2008 final rule, this unambiguously referred to loans subject to the original protections of HOEPA, implemented through Regulation Z's Sec. 226.32, 12 CFR 226.32. The July final rule, however, created a new Sec. 226.35 of Regulation Z, 12 CFR 226.35, which affords certain protections for mortgage loans that meet or exceed its coverage test (the same test that is implemented for HMDA rate spread reporting purposes by this final rule). As the Board created the Sec. 226.35 protections pursuant to its authority under HOEPA, 15 U.S.C. 1639(l)(2), the commenters expressed concern that loans that are subject to those new protections could be seen as being ``subject to'' HOEPA.

Appendix A to Regulation C, Paragraph I.G.3, requires reporting if a loan is subject to HOEPA, ``as implemented in Regulation Z (12 CFR 226.32).'' To eliminate any possibility of misinterpretation, however, the Board is revising the language of Sec. 203.4(a)(13) to conform to the existing rule, as expressed in appendix A.

V. Effective Date

The Board proposed an effective date of January 1, 2009. Industry commenters expressed serious concerns, however, that the proposed effective date would afford too little time, and would generate substantial costs, to implement the necessary systems changes and staff training. For the following reasons, the Board is adopting an effective date of October 1, 2009.

Under the July 30, 2008 final rule, the Regulation Z amendments concerning higher-priced mortgage loans are effective on October 1, 2009 and apply to loans for which applications are taken on or after that date. In the proposed rule, the Board sought to avoid changing rules for HMDA rate spread reporting during a calendar year. But, as the proposal noted, if the Board were to make compliance with this final rule mandatory January 1, 2010, from October through December of 2009 lenders would have to comply with two different rules for identifying higher-priced mortgage loans. These reasons led the Board to propose a January 1, 2009 effective date.

The Board recognizes that several factors would make compliance by January 1, 2009 especially difficult and costly for industry. First, as commenters pointed out, HMDA reporters must capture two additional data elements to apply the new test: (i) Whether the loan is variable-rate or not; and (ii) if variable-rate, the initial, fixed-rate

[[Page 63334]]

period. While these data usually reside in lenders' origination systems, they may be difficult to access, capture, and import into HMDA compliance systems; many industry commenters indicated that these are two separate, non-integrated systems and that creating the necessary interfaces between them will be an extensive and costly project. Second, industry commenters stated that the period over the end of one year and the beginning of the next year is a particularly challenging timeframe in which to implement changes to HMDA reporting systems, as

Copyright © 2009 Association of Corporate Counsel

it coincides with annual reporting under HMDA and other laws and regulations. During this period, lenders generally ``freeze'' their systems to ensure that their reports for the just-completed year are complete and accurate, in compliance with current rules, thus introducing new rules is particularly challenging in this timeframe. Third, mortgage lenders face a number of other compliance-driven systems changes during the proposed timeframe.\4\

\4\ The joint, industry trade groups' comment letter recited six other current sources of significant compliance systems changes, including certain FHA program changes, changes to Regulation Z necessitated by the Mortgage Disclosure Improvement Act of 2008, Title V of Division B of the Housing and Economic Recovery Act of 2008, Public Law 110-289, 122 Stat. 2654, approved July 30, 2008, and numerous state law changes.

As noted above, the new protections for higher-priced mortgage loans under Regulation Z become effective October 1, 2009. As the coverage test necessary to determine whether those protections apply is identical to the HMDA rate spread reporting test adopted here, the Board has concluded that making the HMDA test effective on the same date will impose little additional burden on HMDA reporters.

For the foregoing reasons, the Board is adopting an effective date of October 1, 2009. Lenders will use the new rate spread reporting test on loans for which applications are taken on and after October 1, 2009 and for all loans consummated on or after January 1, 2010 (regardless of their application dates). To help data users identify loans closed in 2009 and reported using the new rule, the Board will add a notation to each such loan in the publicly available data reported for 2009. The mandatory compliance with the new rule for all loans consummated on and after January 1, 2010 will eliminate the need for such notations in years after 2009. Thus, for loans for which applications were taken before October 1, 2009 and that are consummated in 2009, the revised rules do not apply. Lenders will apply the existing rate spread reporting test, using Treasury security yield benchmarks, for those loans. For loans for which applications were taken before October 1, 2009 and that are consummated in 2010 or later, the revised rules apply.

VI. Paperwork Reduction Act

In accordance with section 3506 of the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 35; 5 CFR Part 1320 Appendix A.1), the Board has reviewed the final rule under the authority delegated to the Board by Office of Management and Budget (OMB). The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, this information collection unless it displays a currently valid OMB number. The OMB control number is 7100-0247.

The information collection requirements of this rule appear in 12 CFR part 203. The information collection is mandatory under 12 U.S.C. 2801-2810. It generates data used to help determine whether financial institutions are serving the housing needs of their communities, to help target investment, to promote private investment where it is needed, and to provide data to assist in identifying possibly discriminatory lending patterns and in enforcing antidiscrimination statutes.

The respondents are all types of financial institutions that meet the tests for coverage under the regulation. Under the Paperwork

Copyright © 2009 Association of Corporate Counsel

Reduction Act (PRA), however, the Federal Reserve accounts for the burden of the paperwork associated with the regulation only for state member banks, their subsidiaries, subsidiaries of bank holding companies, U.S. branches and agencies of foreign banks (other than federal branches, federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601-604a; 611-631). Other federal agencies account for the paperwork burden for the institutions they supervise. Respondents must maintain their loan/application registers and modified registers for three years, and their disclosure statements for five years.

The Board has determined that the data collection and reporting are required by law; completion of the loan/application register, submission to the Board, and disclosure to the public upon request are mandatory. The data, as modified according to the regulation, are made publicly available and are not considered confidential. Information that might identify an individual borrower or applicant is given confidential treatment under exemption 6 of the Freedom of Information Act, 5 U.S.C. 552(b)(6).

On July 30, 2008, a notice of proposed rulemaking (NPR) was published in the Federal Register. 73 FR 44189 (July 30, 2008). The NPR indicated that current burden estimates for Regulation C would not change, other than a one-time increase in burden to modify HMDA reporters' systems. No comments specifically addressing the burden estimate were received. Therefore, the current burden estimates will remain unchanged. The current total annual burden to comply with the provisions of Regulation C continues to be estimated at 156,910 hours for 680 Federal Reserve-regulated institutions that are deemed to be respondents for the purposes of the PRA. The reporting, recordkeeping, and disclosure burden for this information collection is estimated to vary from 12 to 12,000 hours per respondent per year, with an average of 242 hours for state member banks and an average of 192 hours for mortgage banking subsidiaries and other respondents. This estimated burden includes time to gather and maintain the data needed, review the instructions, and complete the register. The Board estimates that respondents regulated by the Federal Reserve will take, on average, 16 hours (two business days) to revise and update their systems to comply with the new threshold for rate spread reporting. This one-time revision will increase the burden by 10,880 hours to 167,790.

The Board has a continuing interest in the public's opinions of its collections of information. At any time, comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551, with copies of such comments sent to the Office of Management and Budget, Paperwork Reduction Project (7100-0247), Washington, DC 20503.

VII. Regulatory Flexibility Analysis

In accordance with section 4 of the Regulatory Flexibility Act (RFA), 5 U.S.C. 601-612, the Board is publishing a final regulatory flexibility analysis for the proposed amendments to Regulation C. The RFA requires an agency either to provide a final regulatory flexibility analysis with a final rule or certify that the final rule will not have a significant economic impact on a substantial number of small entities. An entity is considered ''small'' if it has $165

[[Page 63335]]

Copyright © 2009 Association of Corporate Counsel

million or less in assets for banks and other depository institutions; and $6.5 million or less in revenues for non-bank mortgage lenders, mortgage brokers, and loan servicers. The Board did not receive any comments contending that the proposed rule would have a significant impact on various businesses or on its initial regulatory flexibility analysis. Based on its analysis and for the reasons stated below, the Board believes that this final rule will not have a significant economic impact on a substantial number of small entities.

A. Statement of the Need for, and Objectives of, the Final Rule

The Board is adopting amendments to Regulation C to make the rules for reporting higher-priced loans in the annual HMDA data consistent with the definition of ``higher-priced mortgage loan'' in the amendments to Regulation Z (Truth in Lending) that the Board adopted in final form on July 30, 2008. The amendments are intended to reduce regulatory burden by allowing mortgage lenders to use a single definition of higher-priced loan, rather than different definitions under the two regulations. The amendments are also intended to result in more useful HMDA data because the new definition of higher-priced loan uses a survey-based estimate of market mortgage rates as the benchmark for reporting.

The purpose of HMDA is to provide to public officials, and to the public, information to enable them to determine whether lending institutions are fulfilling their obligations to serve the housing needs of their communities. The purpose of the law is also to assist public officials in determining the distribution of public sector investments in a manner designed to improve the private investment environment. 12 U.S.C. 2801(b). HMDA data also assist in identifying possibly discriminatory lending patterns and in enforcing antidiscrimination statutes. HMDA authorizes the Board to prescribe regulations to carry out the purposes of the statute. 12 U.S.C. 2804(a).

The act expressly states that the Board's regulations may contain ``such classifications, differentiations, or other provisions * * * as in the judgment of the Board are necessary and proper to effectuate the purposes of [HMDA], and prevent circumvention or evasion thereof, or to facilitate compliance therewith.'' 12 U.S.C. 2804(a). The Board believes that the amendments to Regulation C discussed above are within Congress's broad grant of authority to the Board to adopt provisions that carry out the purposes of the statute.

B. Summary of Issues Raised by Comments in Response to the Initial Regulatory Flexibility Analysis

The Board did not receive any comments contending that the proposed rule would have a significant impact on various businesses or on its initial regulatory flexibility analysis.

C. Description and Estimate of Small Entities To Which the Proposed Rule Would Apply

The final rule will apply to all institutions that are required to report under HMDA. The Board does not have complete data on the asset sizes of all HMDA reporting institutions. Through data from Reports of Condition and Income (``Call Reports'') of depository institutions and certain subsidiaries of banks and bank holding companies, however, the Board can determine numbers of small entities among those categories. For the majority of HMDA respondents that are non-depository

Copyright © 2009 Association of Corporate Counsel

institutions exact asset size information is not available. The Board has somewhat reliable estimates based in large measure on self-reporting from approximately five percent of the non-depository respondents. Based on the best information available for each category of respondent, the Board makes the following estimate of small entities that will be affected by this final rule: Of all HMDA respondents in 2008 (for 2007 activities), which number approximately 8,625, approximately 4,520 had total domestic assets of $165 million or less and thus would be considered small entities for purposes of the Regulatory Flexibility Act. The Board believes that the economic impact on these small entities is not significant.

D. Reporting, Recordkeeping, and Other Compliance Requirements

HMDA reporting is a routine activity for all HMDA respondents, large and small. The changes implemented by this final rule impose a new requirement on HMDA respondents to obtain a publicly available index (average prime offer rates derived from PMMS data) and use it to apply a reporting threshold test to their loan originations. That requirement, however, replaces an existing requirement that is very similar but for the index used. The burden of complying with the new requirement should not differ significantly from the existing burden of complying with the requirement it replaces; that existing burden is addressed in the PRA discussion in part VI above. As is also discussed in the PRA analysis, the Board expects the one-time burden of converting HMDA respondents' systems to employ the new index to average 16 hours (two business days).

E. Steps Taken To Minimize the Economic Impact on Small Entities

The Board solicited comment on any significant alternatives that may provide additional ways to reduce regulatory burden associated with the proposed rule. No comments were received.

List of Subjects in 12 CFR Part 203

Banks, Banking, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements.

Authority and Issuance

0
For the reasons set forth in the preamble, the Board amends 12 CFR part 203 as follows:

PART 203--HOME MORTGAGE DISCLOSURE (REGULATION C)

0
1. The authority citation for part 203 continues to read as follows:

Authority: 12 U.S.C. 2801-2810.

0
2. Section 203.4 is amended by revising paragraphs (a)(12) and (a)(13) to read as follows:

Sec. 203.4 Compilation of loan data.

Copyright © 2009 Association of Corporate Counsel

(a) * * *

(12)(i) For originated loans subject to Regulation Z, 12 CFR part 226, the difference between the loan's annual percentage rate (APR) and the average prime offer rate for a comparable transaction as of the date the interest rate is set, if that difference is equal to or greater than 1.5 percentage points for loans secured by a first lien on a dwelling, or equal to or greater than 3.5 percentage points for loans secured by a subordinate lien on a dwelling.

(ii) ``Average prime offer rate'' means an annual percentage rate that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage loans that have low-risk pricing characteristics. The Board publishes average prime offer rates for a broad range of types of transactions in tables updated at least weekly, as well as the methodology the Board uses to derive these rates.

(13) Whether the loan is subject to the Home Ownership and Equity Protection Act of 1994, as implemented in Regulation Z (12 CFR 226.32).

* * * * *

0

3. In Appendix A to Part 203, under I. Instructions for Completion of Loan/Application Register, paragraphs I.G.1.a., I.G.1.d., I.G.1.e., and I.G.2. are revised to read as follows:

[[Page 63336]]

Appendix A to Part 203--Form and Instructions for Completion of HMDA Loan/Application Register

* * * * *

I. Instructions for Completion of Loan/Application Register

* * * * *

G. Pricing-Related Data

1. Rate Spread

a. For a home-purchase loan, a refinancing, or a dwelling-secured home improvement loan that you originated, report the spread between the annual percentage rate (APR) and the average prime offer rate for a comparable transaction if the spread is equal to or greater than 1.5 percentage points for first-lien loans or 3.5 percentage points for subordinate-lien loans. To determine whether the rate spread meets this threshold, use the average prime offer rate in effect for the type of transaction as of the date the interest rate was set, and use the APR for the loan, as calculated and disclosed to the consumer under Sec. 226.6 or 226.18, as applicable, of Regulation Z (12 CFR part 226). Current and historic average prime offer rates are set forth in the tables published on the FFIEC's Web site (http://www.ffiec.gov/hmda) entitled ``Average Prime Offer Rates--Fixed'' and ``Average Prime Offer Rates--Adjustable.'' Use the most recently available average prime offer rate. ``Most recently available'' means the average prime offer rate set forth in the applicable table with the most recent effective date as of the date the interest rate was set. Do not use an average prime offer rate before its effective date.

d. Enter the rate spread to two decimal places, and use a leading zero. For example, enter 03.29. If the difference between

Copyright © 2009 Association of Corporate Counsel

the APR and the average prime offer rate is a figure with more than two decimal places, round the figure or truncate the digits beyond two decimal places.

e. If the difference between the APR and the average prime offer rate is less than 1.5 percentage points for a first-lien loan and less than 3.5 percentage points for a subordinate-lien loan, enter ``NA.''

2. Date the interest rate was set. The relevant date to use to determine the average prime offer rate for a comparable transaction is the date on which the loan's interest rate was set by the financial institution for the final time before closing. If an interest rate is set pursuant to a ``lock-in'' agreement between the lender and the borrower, then the date on which the agreement fixes the interest rate is the date the rate was set. If a rate is re-set after a lock-in agreement is executed (for example, because the borrower exercises a float-down option or the agreement expires), then the relevant date is the date the rate is re-set for the final time before closing. If no lock-in agreement is executed, then the relevant date is the date on which the institution sets the rate for the final time before closing.

* * * * *

0

4. In Supplement I to Part 203, under Section 203.4--Compilation of Loan Data, 4(a) Data Format and Itemization, Paragraph 4(a)(12) Rate spread information, paragraph 4(a)(12)-1 is removed, and new heading Paragraph 4(a)(12)(ii) and new paragraphs 4(a)(12)(ii)-1, 4(a)(12)(ii)-2, and 4(a)(12)(ii)-3 are added to read as follows:

Supplement I to Part 203--Staff Commentary

* * * * *

Section 203.4--Compilation of Loan Data

4(a) Data Format and Itemization

* * * * *

Paragraph 4(a)(12) Rate spread information.

Paragraph 4(a)(12)(ii).

1. Average prime offer rate. Average prime offer rates are annual percentage rates derived from average interest rates, points, and other loan pricing terms offered to borrowers by a representative sample of lenders for mortgage loans that have low-risk pricing characteristics. Other pricing terms include commonly used indices, margins, and initial fixed-rate periods for variable-rate transactions. Relevant pricing characteristics include a consumer's credit history and transaction characteristics such as the loan-to-value ratio, owner-occupant status, and purpose of the transaction. To obtain average prime offer rates, the Board uses a survey of lenders that both meets the criteria of Sec. 203.4(a)(12)(ii) and provides pricing terms for at least two types of variable-rate transactions and at least two types of non-variable-rate transactions. An example of such a survey is the Freddie Mac Primary Mortgage Market Survey[supreg].

2. Comparable transaction. The rate spread reporting requirement applies to a reportable loan with an annual percentage rate that exceeds by the specified margin (or more) the average prime offer rate for a comparable transaction as of the date the interest rate is set. The tables of average prime offer rates published by the

Copyright © 2009 Association of Corporate Counsel

Board (see comment 4(a)(12)(ii)-3) indicate how to identify the comparable transaction.

3. Board tables. The Board publishes on the FFIEC's Web site (http://www.ffiec.gov/hmda), in table form, average prime offer rates for a wide variety of transaction types. The Board calculates an annual percentage rate, consistent with Regulation Z (see 12 CFR 226.22 and part 226, appendix J), for each transaction type for which pricing terms are available from the survey described in comment 4(a)(12)(ii)-1. The Board estimates annual percentage rates for other types of transactions for which direct survey data are not available based on the loan pricing terms available in the survey and other information. The Board publishes on the FFIEC's Web site the methodology it uses to arrive at these estimates.

* * * * *

By order of the Board of Governors of the Federal Reserve System, October 20, 2008.
Jennifer J. Johnson,
Secretary of the Board.

Attachment I--Methodology for Determining Average Prime Offer Rates

The calculation of average prime offer rates is based on the Freddie Mac Primary Mortgage Market Survey[supreg] (PMMS). The survey collects data for a hypothetical, ``best quality,'' 80% loan-to-value, first-lien loan for four mortgage products: (1) 30-year fixed-rate; (2) 15-year fixed-rate; (3) one-year variable-rate; and (4) five-year variable-rate.\5\ Each of the variable-rate products adjusts to an index based on the one-year Treasury rate plus a margin and adjusts annually after the initial, fixed-rate period. This Methodology first describes all the steps necessary to calculate average prime offer rates and then provides a numerical example illustrating each step with the data from the week of May 19, 2008.

\5\ The ``30-year'' and ``15-year'' fixed-rate product designations refer to those products' terms to maturity. The ``one-year'' and ``five-year'' variable-rate product designations, on the other hand, refer to those products' initial, fixed-rate periods. All variable-rate products discussed in this Methodology have 30-year terms to maturity.

The PMMS collects nationwide average offer prices during the Monday through Wednesday period each week and publicly releases the averages on Thursday. For each loan type the average commitment loan rate and total fees and points (``points'') are reported, with the points expressed as percentages of the initial loan balance. For the fixed-rate products, the commitment rate is the contract rate on the loan; for the variable-rate products it is the initial contract rate. For the variable-rate products, the average margin is also reported.

The PMMS data are used to compute an annual percentage rate (APR) for the 30- and 15-year fixed-rate products. For the two variable-rate products, an estimate of the fully-indexed rate (the sum of the index and margin) is calculated as the margin (collected in the survey) plus the current one-year Treasury rate, which is estimated as the average of the close-of-business, one-year Treasury rates for Monday, Tuesday, and Wednesday of the survey week. If data are available for fewer than three days, only yields for the available days are used for the average. Survey data on the initial interest rate and points, and the

Copyright © 2009 Association of Corporate Counsel

estimated fully indexed rate, are used to compute a composite APR for the one- and five-year variable-rate mortgage products. See Regulation Z official staff commentary, 12 CFR part

[[Page 63337]]

226, Supp. I, comment 17(c)(1)-10 (creditors to compute a composite APR where initial rate on variable-rate transaction not determined by reference to index and margin).

In computing the APR for all four PMMS products, a fully amortizing loan is assumed, with monthly compounding. A two-percentage-point cap on the annual interest rate adjustments is assumed for the variable-rate products. For all four products, the APR is calculated using the actuarial method, pursuant to appendix J to Regulation Z. A payment schedule is used that assumes equal monthly payments (even if this entails fractions of cents), assumes each payment due date to be the 1st of the month regardless of the calendar day on which it falls, treats all months as having 30 days, and ignores the occurrence of leap years. See 12 CFR 226.17(c)(3). The APR calculation also assumes no irregular first period or per diem interest collected.

The PMMS data do not cover fixed-rate loans with terms to maturity of other than 15 or 30 years and do not cover variable-rate mortgages with initial, fixed-rate periods of other than one or five years. The Board uses interpolation techniques to estimate APRs for ten additional products (two-, three-, seven-, and ten-year variable-rate loans and one-, two-, three-, five-, seven-, and ten-year fixed-rate loans) to use along with the four products directly surveyed in the PMMS.

The Treasury Department makes available yields on its securities with terms to maturity of, among others, one, two, three, five, seven, and ten years (see http://www.treas.gov/offices/domestic-finance/debt-management/interest-rate/yield.shtml). The Board uses these data to estimate APRs for two-, three-, seven-, and ten-year variable-rate mortgages. These additional variable-rate products are assumed to have the same terms and features as the one- and five-year variable-rate products surveyed in the PMMS other than the length of the initial, fixed-rate period.

The margin and points for the two- and three-year variable-rate products are estimated as weighted averages of the margins and points of the one-year and five-year variable-rate products reported in the PMMS. For the two-year variable-rate loan the weights are \3/4\ for the one-year variable-rate and \1/4\ for the five-year variable-rate. For the three-year variable-rate product, the weights are \1/2\ each for the one-year and the five-year variable rate. For the seven- and ten-year variable-rate products, because they fall outside of the range between the one- and five-year PMMS variable-rate products, the margin and points of the five-year variable-rate product reported in the PMMS are used instead of calculating a weighted average.

The initial interest rate for each of the interpolated variable-rate products is estimated by a two-step process. First, ``Treasury spreads'' are computed for the two- and three-year variable-rate loans as the weighted averages of the spreads between the initial interest rates on the one- and five-year PMMS variable-rate products and the one- and five-year Treasury yields, respectively. The weights used are the same as those used in the calculation of margins and points. For seven- and ten-year variable-rate loans, because they fall outside of the range between the one- and five-year PMMS variable-rate products, the spread between the initial interest rate on the five-year PMMS variable-rate product and the five-year Treasury yield is used as the Treasury spread instead of calculating a weighted average. The second step is to add the appropriate Treasury spread to the Treasury yield

Copyright © 2009 Association of Corporate Counsel

for the appropriate initial, fixed-rate period. All Treasury yields used in this two-step process are the Monday-Wednesday close-of-business averages, as described above. Thus, for example, for the two-year variable-rate product the estimated, two-year Treasury spread is added to the average two-year Treasury rate, and for the ten-year variable-rate product the five-year Treasury spread is added to the average ten-year Treasury rate.

Thus estimated, the initial rates, margins, and points are used to calculate a fully-indexed rate and ultimately an APR for the two-, three-, seven- and ten-year variable-rate products. To estimate APRs for one-, two-, three-, five-, seven-, and ten-year fixed-rate loans, respectively, the Board uses the initial interest rates and points, but not the fully-indexed rates, of the one-, two-, three-, five-, seven-, and ten-year variable-rate loan products calculated above.

For any loan for which an APR of the same term to maturity or initial, fixed-rate period, as applicable, (collectively, for purposes of this paragraph, ``term'') is not included among the 14 products derived or estimated from the PMMS data by the calculations above, the comparable transaction is identified by the following assignment rules: For a loan with a shorter term than the shortest applicable term for which an APR is derived or estimated above, the APR of the shortest term is used. For a loan with a longer term than the longest applicable term for which an APR is derived or estimated above, the APR of the longest term is used. For all other loans, the APR of the applicable term closest to the loan's term is used; if the loan is exactly halfway between two terms, the shorter of the two is used. For example: For a loan with a term of eight years, the applicable (fixed-rate or variable-rate) seven-year APR is used; with a term of six months, the applicable one-year APR is used; with a term of nine years, the applicable ten-year APR is used; with a term of 11 years, the applicable ten-year APR is used; and with a term of four years, the applicable three-year APR is used. For a fixed-rate loan with a term of 16 years, the 15-year fixed-rate APR is used; and with a term of 35 years, the 30-year fixed-rate APR is used.

The four APRs derived directly from PMMS product data, the ten additional APRs estimated from PMMS data in the manner described above, and the APRs determined by the foregoing assignment rules are the average prime offer rates for their respective comparable transactions. The PMMS data needed for the above calculations generally are available on the Freddie Mac Web site (http://www.freddiemac.com/dlink/html/PMMS/display/PMMSOutputYr.jsp) on Thursday of each week. APRs representing average prime offer rates for the 14 products derived or estimated as above are posted in tables on the FFIEC Web site the following day. Those average prime offer rates are effective beginning the following Monday and until the next posting takes effect.

Numerical Example

The week of May 19 through 25, 2008 is used to illustrate the average prime offer rate calculation Methodology. On Thursday May 15, Freddie Mac released the following PMMS information reflecting national mortgage rate averages for the three day period May 12 through May 14 (each variable is expressed in percentage points):

30-year fixed-rate:
    Contract rate--6.01
    Fees & Points--0.6
15-year fixed-rate:
    Contract rate--5.60
    Fees & Points--0.5

Copyright © 2009 Association of Corporate Counsel

Five-year variable-rate:
Initial rate--5.57
Fees & Points--0.6
Margin--2.75
One-year variable-rate:
Initial rate--5.18
Fees & Points--0.7
Margin--2.75

The Freddie Mac survey contract rate and points for the 30-year and 15-year

[[Page 63338]]

fixed-rate mortgages are used to compute APRs for these two products:

30-year fixed-rate--6.07
15-year fixed-rate--5.68

As a preliminary step in calculating APRs for the one-year and five-year variable-rate products, average close-of-business Treasury yields for the three days in which the survey was conducted are calculated (the three yields summed before dividing by three are the close-of-business yields reported for May 12th, 13th, and 14th):

One-year Treasury--(2.01+2.08+2.11)/3=2.07
Two-year Treasury--(2.30+2.57+2.53)/3=2.43
Three-year Treasury--(2.54+2.70+2.78)/3=2.67
Five-year Treasury--(3.00+3.17+3.22)/3=3.13
Seven-year Treasury--(3.34+3.49+3.50)/3=3.44
Ten-year Treasury--(3.78+3.90+3.92)/3=3.87

The fully-indexed rate for the one-year variable-rate mortgage is calculated as the one-year Treasury yield plus the margin: 2.07+2.75=4.82 Because both variable-rate products in the PMMS data use the same margin, the fully-indexed rate for the five-year variable-rate mortgage is the same number: 2.07+2.75=4.82 (since each adjusts to the 1-year treasury).

The initial rate, points, and fully-indexed rate are used to compute APRs for the one-year and five-year variable-rate products:

One-year variable-rate--4.91
Five-year variable-rate--5.16

Data for the interpolated two-year and three-year variable-rate mortgages are calculated as weighted averages of the figures for the one- and five-year variable-rates, which are used in conjunction with the yields on the two- and three-year Treasuries as follows:

Two-year variable-rate:
Initial rate--[3x(5.18-2.07)+1x(5.57-3.13)]/4+2.43=5.37
Fees & Points--[3x.7+1x.6]/4=.7
Margin--[3x2.75+1x2.75]/4=2.75
Fully-indexed rate--2.07+2.75=4.82
Three-year variable-rate:
Initial rate--[2x(5.18-2.07)+2x(5.57-3.13)]/4+2.67=5.45
Fees & Points--[2x.7+2x.6]/4=.7
Margin--[2x2.75+2x2.75]/4=2.75
Fully-indexed rate--2.07+2.75=4.82

Copyright © 2009 Association of Corporate Counsel

The foregoing initial rates, points, margins, and fully-indexed rates are used to calculate APRs for the two- and three-year variable-rate products:

Two-year variable-rate--4.97
Three-year variable-rate--5.03

Data for the seven-year and ten-year variable-rate products are estimated using the survey data for the five-year variable-rate product and yields on the seven- and ten-year Treasuries:

Seven-year variable-rate:
    Initial rate--(5.57-3.13)+3.44=5.88
    Fees & Points--=.6
    Margin--=2.75
    Fully-indexed rate--2.07+2.75=4.82
Ten-year variable-rate:
    Initial rate--(5.57-3.13)+3.87=6.31
    Fees & Points--=.6
    Margin--=2.75
    Fully-indexed rate--2.07+2.75=4.82

The foregoing initial rates, points, margins, and fully-indexed rates are used to calculate APRs for the seven- and ten-year variable-rate products:

Seven-year variable-rate--5.40
Ten-year variable-rate--5.85

The initial rate and points of the variable-rate mortgages calculated above are used to estimate APRs for fixed-rate products with terms to maturity of ten years or less:

One-year fixed:
    Initial rate--5.18
    Fees & Points--.7
    APR--6.49
Two-year fixed:
    Initial rate--5.37
    Fees & Points--.7
    APR--6.06
Three-year fixed:
    Initial rate--5.45
    Fees & Points--.7
    APR--5.92
Five-year fixed:
    Initial rate--5.57
    Fees & Points--.6
    APR--5.82
Seven-year fixed:
    Initial rate--5.88
    Fees & Points--.6
    APR--6.06
Ten-year fixed:
    Initial rate--6.31
    Fees & Points--.6
    APR--6.44

[FR Doc. E8-25320 Filed 10-23-08; 8:45 am]

BILLING CODE 6210-01-P

Copyright © 2009 Association of Corporate Counsel

Truth-in-Lending Act Materials

Part A – FDIC Institution Letter FIL-26-2009

Part B – Final Rule

Copyright © 2009 Association of Corporate Counsel

Part A – FDIC Institution Letter FIL-26-2009

Copyright © 2009 Association of Corporate Counsel

Home > News & Events > Financial Institution Letters

Financial Institution Letters

Regulation Z (Truth in Lending) Early Disclosure Requirements

FIL-26-2009
June 1, 2009

Summary: During 2008, the Federal Reserve promulgated revisions to Regulation Z (Truth in Lending) closed-end mortgage early disclosure requirements that were to take effect October 1, 2009. However, these changes were superseded by the enactment of the Mortgage Disclosure Improvement Act of 2008 (MDIA). As a result, the Federal Reserve has revised Regulation Z to incorporate the MDIA amendments. Compliance with the revised early disclosure requirements is mandatory on July 30, 2009.

Highlights:
The revisions to the Truth in Lending Act (TILA) early disclosure requirements, incorporating the MDIA amendments:

- expand the requirements to mortgage loans secured by *any* dwelling of a consumer. The requirements no longer are limited to a consumer's "principal" dwelling. The early disclosure requirements also now cover refinancings and home equity loans.
- require delivery or mailing of the early disclosures within three business days of receiving a consumer's mortgage loan application. A lender also must wait until at least seven business days after delivery of the disclosures before consummating the mortgage loan.
- require corrected disclosures to be delivered at least three business days before consummation if the annual percentage rate provided in the early disclosures changes beyond the tolerances provided in Section 226.22.
- prohibit a lender from charging a consumer any fee, except to obtain a credit report, until after the early disclosures have been provided.
- permit a consumer to expedite the closing of a mortgage loan subject to the early disclosure provisions to address a personal financial emergency, such as foreclosure.
- inform a consumer that he or she is not required to complete the transaction because the consumer has received the early disclosures or applied for a loan.

(See the attached supplement for a comparison of the 2008 and 2009 revisions and FIL-134-2008 for an overview of the 2008 revisions.)

Distribution:
FDIC-supervised Banks (Commercial and Savings)

Suggested Routing:
Chief Executive Officer
Chief Loan Officer
Chief Compliance Officer
General Counsel

Attachment:
Supplement to FIL-26-2009: Regulation Z (Truth in Lending) Early Disclosures Requirements
Supplement to FIL-26-2009: Regulation Z (Truth in Lending) Early Disclosures Requirements - PDF
(PDF Help)

Related Topics:
Truth in Lending Act
Mortgage Disclosure Improvement Act of 2008
FIL-134-2008:

Copyright © 2009 Association of Corporate Counsel

http://www.fdic.gov/news/news/financial/2008/fil08134.html
12 CFR Part 226, final rule:
http://edocket.access.gpo.gov/2009/pdf/E9-11567.pdf (PDF Help)

Contact:
Senior Policy Analyst Glenn S. Gimble at
GGimble@FDIC.gov or (202) 898-6865

Printable Format:
FIL-26-2009 - PDF (PDF Help)

Note:
FDIC financial institution letters (FILs) may be accessed from the FDIC's Web site at www.fdic.gov/news/news/financial/2009/index.html.

To receive FILs electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html.

Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center, 3501 Fairfax Drive, E-1002, Arlington, VA 22226 (1-877-275-3342 or 703- 562-2200).

Last Updated 6/1/2009
communications@fdic.gov

Home Contact Us Search Help SiteMap Forms
Freedom of Information Act (FOIA) Service Center Website Policies USA.gov
FDIC Office of Inspector General

Copyright © 2009 Association of Corporate Counsel

Home > News & Events > Financial Institution Letters

Financial Institution Letters

Supplement to FIL-26-2009: Regulation Z (Truth In Lending) Early Disclosure Requirements

During 2008, the Federal Reserve promulgated amendments to Regulation Z closed-end mortgage early disclosure requirements that were to take effect October 1, 2009. However, the 2008 regulatory amendments were superseded by the enactment of the Mortgage Disclosure Improvement Act of 2008 (MDIA). Pursuant to the MDIA, in May of 2009 the Federal Reserve revised Regulation Z early disclosure requirements to incorporate the MDIA statutory provisions. Compliance with the revised early disclosure requirements is mandatory on July 30, 2009.

All written applications received by mortgage lenders on or after July 30, 2009, must comply with the early disclosure requirements of Regulation Z as amended in May of 2009.

The chart below highlights the differences between the 2008 early disclosure amendments to Regulation Z and the superseding 2009 amendments that take effect July 30, 2009.

Regulation Z Early Disclosure Requirements of Section 226.19
2008 Revisions (superseded except as noted) vs. 2009 Revisions

Early TIL Disclosure	2008 Revisions	2009 Revisions (effective 7/30/09)
Applies to:	Loans to purchase or construct home, refinance home loans, and home equity loans	Same
Secured by:	Principal dwelling	Any consumer dwelling
Timing of delivery:	Within 3 business days of application	Within 3 business days of application and at least 7 business days before consummation (Timing waiver for bona fide emergency)
Content:	Good faith estimate of § 226.18 disclosures	Good faith estimate of § 226.18 disclosures and the statement: "You are not required to complete this agreement merely because you have received these disclosures or signed a loan application."
Timing of re-disclosure (if APR outside § 226.22 tolerance):	Must be given no later than consummation or settlement	Must be given at least 3 business days before consummation
Application Fee:	No fee allowed until after early disclosures provided, except for a credit report fee	Same

Last Updated 6/1/2009 communications@fdic.gov

Home Contact Us Search Help SiteMap Forms
Freedom of Information Act (FOIA) Service Center Website Policies USA.gov
FDIC Office of Inspector General

http://www.fdic.gov/news/news/financial/2009/fil09026a.html 7/15/2009

Copyright © 2009 Association of Corporate Counsel

Part B – Final Rule

Copyright © 2009 Association of Corporate Counsel

Rules and Regulations

Federal Register
Vol. 74, No. 95
Tuesday, May 19, 2009

This section of the FEDERAL REGISTER contains regulatory documents having general applicability and legal effect, most of which are keyed to and codified in the Code of Federal Regulations, which is published under 50 titles pursuant to 44 U.S.C. 1510.

The Code of Federal Regulations is sold by the Superintendent of Documents. Prices of new books are listed in the first FEDERAL REGISTER issue of each week.

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R–1340]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule; official staff commentary.

SUMMARY: On July 30, 2008, the Board published a final rule amending Regulation Z, which implements the Truth in Lending Act (TILA) and the Home Ownership and Equity Protection Act (HOEPA). The July 2008 final rule requires creditors to give consumers transaction-specific cost disclosures shortly after application for closed-end loans secured by a consumer's principal dwelling. The disclosures must be provided before the consumer pays any fee, other than a fee for obtaining the consumer's credit history. Also on July 30, 2008, the Congress enacted the Housing and Economic Recovery Act of 2008, which included amendments to TILA, known as the Mortgage Disclosure Improvement Act of 2008 (MDIA). On October 3, 2008, the Congress amended the MDIA in connection with its enactment of the Emergency Economic Stabilization Act of 2008 (Stabilization Act). The Board is now revising Regulation Z to implement the provisions of the MDIA, as amended.

The MDIA broadens and adds to the requirements of the Board's July 2008 final rule. Among other things, the MDIA requires early, transaction-specific disclosures for mortgage loans secured by dwellings other than the consumer's principal dwelling and requires waiting periods between the time when disclosures are given and consummation of the mortgage transaction. Moreover, these requirements of the MDIA will become effective on July 30, 2009, about two months earlier than the Board's regulatory amendments adopted in the July 2008 final rule.

Consistent with the MDIA, the final rule amending Regulation Z requires creditors to make good faith estimates of the required mortgage disclosures, and deliver or place them in the mail, no later than three business days after receiving a consumer's application for a dwelling-secured closed-end loan. Consummation may occur on or after the seventh business day after the delivery or mailing of these disclosures. If the annual percentage rate provided in the good faith estimates changes beyond a specified tolerance for accuracy, creditors must provide corrected disclosures, which the consumer must receive on or before the third business day before consummation of the transaction. The final rule allows consumers to expedite consummation to meet a *bona fide* personal financial emergency. The MDIA, as amended by the Stabilization Act, specifies different requirements for providing early disclosures for mortgage transactions that are secured by a consumer's interest in a timeshare plan.

DATES: The amendments to §§ 226.2(a)(6), 226.17(b) and (f), and 226.19(a)(1); and amendments 13, 14, 16, and 17 to Supplement I to part 226, published on July 30, 2008 (73 FR 44522), previously to become effective on October 1, 2009, are now effective on July 30, 2009.

Additionally, this final rule is also effective on July 30, 2009 and includes further amendments to Regulation Z.

FOR FURTHER INFORMATION CONTACT: Paul Mondor, Senior Attorney, or Jamie Z. Goodson, Attorney; Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452–2412 or (202) 452–3667. For users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263–4869.

SUPPLEMENTARY INFORMATION:

I. Background

One of the purposes of the Truth in Lending Act (TILA), 15 U.S.C. 1601 *et seq.*, is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The act requires creditors to disclose the cost of credit as a dollar amount (the finance charge) and as an annual percentage rate (APR). Uniformity in creditors' disclosures is intended to assist consumers in comparison shopping. TILA requires additional disclosures for loans secured by consumers' homes and permits consumers to rescind certain transactions that involve their principal dwelling.

TILA mandates that the Board prescribe regulations to carry out the purposes of the act. 15 U.S.C. 1604(a). TILA is implemented by the Board's Regulation Z, 12 CFR part 226. An Official Staff Commentary interprets the requirements of the regulation and provides guidance to creditors in applying the rules to specific transactions. *See* 12 CFR part 226 (Supp. I).

TILA Section 128, 15 U.S.C. 1638, requires creditors to make specified disclosures in connection with closed-end consumer credit transactions before the credit is extended. Before amendment by the MDIA, for certain mortgage loans TILA required creditors to make good faith estimates of the disclosures ("early disclosures") within three business days after the consumer has submitted an application or before the credit is extended, whichever is earlier. In implementing TILA Section 128, Regulation Z requires creditors to give these early disclosures only for loans that finance the purchase or initial construction of a consumer's principal dwelling.

On July 30, 2008, the Board published a final rule amending Regulation Z (the July 2008 final rule) (73 FR 44522). The July 2008 final rule requires, among other things, that a creditor provide the early disclosures even when the loan is not for the purpose of financing the purchase or initial construction of the consumer's principal dwelling. Under the July 2008 final rule, the early disclosures also must be provided for non-purchase closed-end loans secured by the consumer's principal dwelling (such as a refinance loan). The July 2008 final rule also required these disclosures to be given before the consumer pays any fee, other than a *bona fide* and reasonable fee for obtaining the consumer's credit history. As published, these provisions of the July 2008 final rule were scheduled to become effective on October 1, 2009 (73 FR at 55494). Consistent with the MDIA, however, this final rule sets an earlier effective date of July 30, 2009 for these fee

collection restrictions, as discussed below.

On the same day that the July 2008 final rule was published, Congress amended TILA by enacting the Mortgage Disclosure Improvement Act of 2008 (MDIA).[1] The MDIA amends TILA and codifies some of the early disclosure requirements of the July 2008 final rule, but also expands upon the regulatory provisions.

Like the July 2008 final rule, the MDIA requires creditors to make the early disclosures even when the loan is not for the purpose of financing the purchase or initial construction of the consumer's principal dwelling and prohibits the collection of fees before the consumer receives the disclosures, other than a fee for obtaining a consumer's credit report. However, the MDIA applies these provisions to loans secured by a dwelling even when it is not the consumer's principal dwelling. Moreover, the MDIA imposes additional requirements not contained in the July 2008 final rule. Under the MDIA, for loans secured by a consumer's dwelling, creditors must deliver or mail the early disclosures at least seven business days before consummation. If the APR contained in the early disclosures becomes inaccurate (for example, due to a change in the loan terms), creditors must "redisclose" and provide corrected disclosures that the consumer must receive at least three business days before consummation. The disclosures also must inform consumers that they are not obligated to complete the transaction simply because disclosures were provided or because a consumer has applied for a loan. The MDIA imposes different requirements for early disclosure in closed-end mortgage transactions that are secured by a consumer's interest in a timeshare plan. These provisions of the MDIA, including the fee collection restriction, will become effective on July 30, 2009, which is about two months earlier than the effective date of the July 2008 final rule.

At this time, the Board is only conforming Regulation Z, as amended on July 30, 2008, to the MDIA provisions that become effective on July 30, 2009. The MDIA also contains additional disclosure requirements for variable-rate transactions that are not addressed in this rulemaking. Those provisions of the MDIA will not become effective until January 30, 2011, or any earlier compliance date ultimately established by the Board. This final rule does not address those disclosures. The Board anticipates issuing proposed amendments to Regulation Z to implement those provisions of the MDIA later during 2009, in connection with the Board's comprehensive review of closed-end mortgage disclosures that is currently underway.

As discussed above, the MDIA contains several provisions that mirror the July 2008 final rule. These provisions are not discussed below because they are explained in detail in the supplementary information portion of the July 2008 final rule. (*See* 73 FR at 44590–44594; July 30, 2008). To conform to the MDIA, certain regulatory changes that the Board adopted in July 2008 will become effective on July 30, 2009 (and not on October 1, 2009 as originally provided in the July 2008 final rule). These regulatory changes are: the requirement that early disclosures be given for all dwelling-secured mortgage loans rather than only for "residential mortgage transactions" to finance the purchase or initial construction of the dwelling (in §§ 226.17(f) and 226.19(a)(1)(i) and associated commentary) and that early disclosures be given before consumers pay any fee except a fee for obtaining the consumer's credit history (in § 226.19(a)(1)(ii) and (iii) and associated commentary). The final rule the Board is publishing today further revises Regulation Z, also effective July 30, 2009. These revisions will apply only if a consumer's application for a covered transaction is received on or after July 30, 2009.

Minor conforming and technical amendments to Regulation Z also are made in this final rule.

II. Overview of Comments Received

On December 10, 2008, the Board published a proposed rule that would amend Regulation Z's rules for the timing and content of disclosures for dwelling-secured mortgage loans. 73 FR 74989. The Board received fifty-one public comment letters. Several financial institutions and financial services trade associations stated that they support efforts to improve the disclosure of credit terms to consumers and recognize that the Board's proposal is intended to conform Regulation Z to TILA, as amended by the MDIA. These commenters generally stated that the Board should make timing requirements as flexible as is possible. Several other financial institutions stated that the costs of the new waiting periods required by the MDIA outweigh any benefits and that consumers would object to delays in consummating a mortgage transaction. By contrast, consumer advocacy organizations generally supported the MDIA's goal of providing accurate disclosure of credit to consumers terms in a timely manner. Consumer advocates further stated that the MDIA provisions allowing consumers to waive the waiting period between disclosure and consummation should be narrowly circumscribed. Comments are discussed in detail below in part III of the **SUPPLEMENTARY INFORMATION**.

III. The Board's Final Rule

A. Coverage of § 226.19(a)

Proposed Rule

TILA Section 128(a), 15 U.S.C. 1638(a), requires creditors to disclose certain information for closed-end consumer credit transactions, including, for example, the amount financed and the APR. TILA Section 128(b)(2), 15 U.S.C. 1638(b)(2), requires creditors to make good faith estimates of these disclosures within three business days of receiving the consumer's application, or before consummation if that occurs earlier. Until the recent enactment of the MDIA, TILA Section 128(b)(2) applied only to a "residential mortgage transaction" subject to the Real Estate Settlement Procedures Act (RESPA). *See* 15 U.S.C. 1602(w). A residential mortgage transaction is defined in TILA as a loan to finance the purchase or initial construction of a consumer's dwelling. Regulation Z limits the definition to transactions secured by the consumer's principal dwelling. *See* § 226.2(a)(24).

The MDIA extends the early disclosure requirement in TILA Section 128(b)(2), 15 U.S.C. 1638(b)(2), to additional types of loans. Under the MDIA, early disclosures are required for "any extension of credit secured by the dwelling of a consumer." Thus, as amended, the statute requires early disclosures for home refinance loans and home equity loans. This is consistent with revisions made by the Board's July 2008 final rule. To implement the MDIA, the Board proposed to also apply the early disclosure requirements to loans secured by dwellings other than the consumer's principal dwelling. Accordingly, the Board proposed, under § 226.19(a)(1)(i), to require creditors to give consumers early disclosures in connection with a dwelling-secured mortgage loan (if also subject to RESPA), whether or not the loan is for the purpose of financing the purchase or initial construction of the consumer's

[1] The MDIA is contained in Sections 2501 through 2503 of the Housing and Economic Recovery Act of 2008 (HERA), Public Law 110–289, enacted on July 30, 2008. The MDIA was amended by the Emergency Economic Stabilization Act of 2008, Public Law 110–343, enacted on October 3, 2008.

principal dwelling. The Board's proposal did not apply to home equity lines of credit (HELOCs), which are subject to the rules for open-end credit in § 226.5b. The July 2008 final rule also did not apply to HELOCs.

TILA Section 128(b)(2), 15 U.S.C. 1638(b)(2), as amended by the MDIA, applies to dwelling-secured mortgage loans if they also are subject to RESPA. The U.S. Department of Housing and Urban Development's (HUD) Regulation X implements RESPA. *See* 12 U.S.C. 2601 *et seq.*; 24 CFR 3500.1 *et seq.* In March 2008, HUD published a proposal to revise Regulation X. (*See* 73 FR 14030; Mar. 14, 2008). In November 2008, HUD published final rules amending Regulation X. (*See* 73 FR 68204; Nov. 17, 2008). The Board believes that Regulation Z's timing requirements for early disclosures, as amended by this final rule, remain consistent with timing requirements for the initial good faith estimates of settlement costs required under Regulation X, as recently amended by HUD. Consistency between Regulation Z and Regulation X are discussed in detail below.

Public Comment

The Board received few comments that addressed the coverage of proposed § 226.19(a). A few financial institutions and financial services trade associations stated that the early disclosure requirements should only apply to loans secured by a consumer's principal dwelling. A financial institution stated that consumers who own more than one dwelling usually are more sophisticated financially and will not benefit from the early disclosures. One financial services trade association supported the extension of coverage to mortgage transactions that are secured by dwellings that are not a consumer's principal dwelling. A few commenters stated that the Board should clarify whether the MDIA's timing requirements apply when the person obligated on the loan does not occupy the dwelling that secures the loan.

Final Rule

As proposed, the final rule applies the early disclosure requirements to loans secured by dwellings other than the consumer's principal dwelling. Under § 226.19(a)(1)(i), creditors must give consumers early disclosures in connection with a dwelling-secured mortgage loan that is subject to RESPA, whether or not the loan is for the purpose of financing the purchase or initial construction of the consumer's principal dwelling. The final rule does not revise the disclosure requirements for home equity lines of credit (HELOCs). The Board is currently reviewing the disclosure rules for real estate-secured loans, including HELOCs, and will consider the need for earlier disclosures in connection with that proposed rulemaking.

A few commenters requested guidance on whether the early disclosure rules apply to a loan secured by a dwelling that is not occupied by the person who is obligated on the loan. If the transaction is a dwelling-secured extension of *consumer* credit, early disclosures would be required regardless of who occupies the dwelling. However, TILA and Regulation Z do not apply to credit extensions that are primarily for *business* purposes. 15 U.S.C. 1603(l); 12 CFR 226.3(a)(1). Existing guidance in comment 3(a)–2 provides that creditors should determine whether a credit extension is business or consumer credit based on the factors stated in the comment. Further, comment 3(a)–3 states that credit extended to acquire, improve, or maintain rental property that is not owner-occupied (that is, in which the owner does not expect to live for more than fourteen days during the coming year) is deemed to be for business purposes. The Board believes this guidance is sufficient to determine whether a transaction is subject to TILA.

B. Timing of Delivery of Early Disclosures—§ 226.19(a)(1)(i)

Proposed Rule

Currently under Regulation Z, creditors must provide the early disclosures within three business days after receiving the consumer's written application or before consummation, whichever is earlier. The MDIA amends TILA to require creditors to deliver or mail the early disclosures at least seven business days before consummation. The Board proposed to further amend § 226.19(a)(1)(i), as published in the July 2008 final rule, to reflect this change. The Board proposed to add comment 19(a)(1)(i)–6 to clarify that consummation may occur any time on the seventh business day following delivery or mailing; the proposed comment provided examples to facilitate compliance. The proposal would have required creditors to calculate the seven-business-day waiting period using the general definition of "business day" (a calendar day on which the creditor's offices are open to the public for carrying on substantially all of its business functions).

Public Comment

Many of the comments the Board received on the requirements for early disclosures discussed the definition of "business day" that should apply for purposes of those requirements. Those comments are discussed in detail below, in part III.D of this **SUPPLEMENTARY INFORMATION**.

Final Rule

Consistent with the MDIA, the final rule adopts the requirement that a creditor deliver or mail the early disclosures for all dwelling-secured mortgage loans no later than three business days after the creditor receives a consumer's application. Also as proposed, the general definition of "business day" (days on which a creditor's offices are open to the public for carrying on substantially all of its business functions) applies for this purpose.

Under the July 2008 final rule, the early disclosures also must be provided for non-purchase closed-end loans secured by the consumer's principal dwelling (such as a refinance loan). The July 2008 final rule also required these disclosures to be given before the consumer pays any fee, other than a *bona fide* and reasonable fee for obtaining the consumer's credit history. This final rule expands these requirements to apply to mortgage transactions secured by a dwelling other than the consumer's principal dwelling (such as a second home) and makes them effective for covered loans for which the creditor receives an application on or after July 30, 2009, consistent with the MDIA.

The requirement for a creditor to deliver or place in the mail the early disclosures no later than the seventh business day before consummation has been moved to § 226.19(a)(2) and modified, as discussed below in part III.C of the **SUPPLEMENTARY INFORMATION**. In addition, under the final rule, the more precise definition of "business day" will apply for purposes of calculating the seven-business-day waiting period, as discussed in detail in part III.D of the **SUPPLEMENTARY INFORMATION**. The Board is revising comment 19(a)(1)(i)–4 to clarify that if a consumer withdraws a loan application within three business days after a creditor receives it, the creditor need not make the early disclosures. This is consistent with comment 5b(b)–5, regarding denial or withdrawal of an application for an open-end home equity plan.

Copyright © 2009 Association of Corporate Counsel

C. Waiting Periods After Early Disclosures and Corrected Disclosures—§ 226.19(a)(2)

Proposed Rule

Currently, when a creditor provides early TILA disclosures and the APR subsequently changes beyond the specified tolerance, the creditor must redisclose the APR and other changed terms no later than consummation or settlement. The MDIA amends TILA Section 128(b)(2), 15 U.S.C. 1638(b)(2), to require that in such cases creditors make corrected disclosures so that consumers receive them not later than the third business day before consummation. The MDIA removes the reference to "settlement" for purposes of this requirement. The Board proposed to amend § 226.19(a)(2) to reflect these changes to TILA. The Board also proposed that consummation could occur any time on the third business day after the consumer receives the corrected disclosure.

In addition, under the proposed rule, if the corrected disclosures are mailed, the consumer is considered to receive the disclosures three business days after mailing. This is consistent with the presumption the Board adopted in the July 2008 final rule in § 226.19(a)(1)(ii) for determining when fees may be imposed on the consumer. The MDIA subsequently codified that presumption. In this rulemaking, the Board proposed to apply the same presumption for purposes of the rule that a consumer must receive corrected disclosures no later than the third business day before consummation. The Board also proposed to revise comment 19(a)(2)–1 to provide examples illustrating the effect of the three-business-day waiting period and when consummation may occur.

The Board proposed to revise comment 19(a)(2)–3 to clarify that the three-business-day waiting period before consummation begins when the disclosures are received by the consumer and not when they are mailed. This is consistent with the MDIA and is also consistent with the rules for certain high-cost loans and reverse mortgage transactions, which also require a creditor to make disclosures at least three business days before consummation. *See* § 226.31(c) and comment 31(c)–1.

Public Comment

Several financial institutions and financial services trade associations stated that the Board's rules should specifically address the timing requirements for the early disclosures when a creditor provides electronic disclosures or uses overnight courier or other delivery methods. Also, many financial institutions and financial services trade associations stated that a three-business-day waiting period before consummation is not warranted if corrected disclosures state an APR that is *lower than* the APR stated in the early disclosures, because the change benefits consumers. One financial institution stated that there should be no three-business-day waiting period before consummation when corrected disclosures are provided if the consumer has three business days to rescind the loan after consummation under § 226.23(a).

A financial services trade association and a financial institution requested guidance for situations where a creditor makes corrected disclosures and thereafter the APR becomes inaccurate again. These commenters stated that, to determine whether the new APR is within the tolerance specified in § 226.22, creditors should be permitted to compare what the APR will be at consummation to the APR stated in the most recent corrected disclosures, not the initial early disclosures. One financial institution stated that the three-business-day waiting period should begin on the date the corrected disclosures are delivered or placed in the mail and not when received.

Final Rule

The Board is adopting § 226.19(a)(2) as proposed; however, the requirement to deliver or mail the early disclosures to the consumer not later than the seventh business day before consummation has been moved to § 226.19(a)(2). (In the proposal, the seven-business-day waiting period was in § 226.19(a)(1)(i).) Under the final rule, when creditors provide corrected disclosures under § 226.19(a)(2), the disclosures must state an accurate APR and all changed terms. Existing comment 19(a)(2)–2 has been redesignated as comment 19(a)(2)(ii)–2.

The final rule also applies the more precise definition of "business day" (all calendar days except Sundays and specified legal public holidays) to the seven-business-day waiting period. This is a change from the proposal, which would have applied the general definition of "business day" to this provision. This change has been made so that the same "business day" definition will be used for purposes of both the seven-business-day waiting period and the three-business-day waiting period, which will make compliance easier, as discussed in detail in part III.D of the SUPPLEMENTARY INFORMATION. The final rule also applies the more precise definition to the three-business-day waiting period, as proposed. Under the proposal, commentary on the applicable "business day" definition was contained in proposed comment 19(a)(2)–3; under the final rule, commentary on the applicable "business day" definition appears in comment 19(a)(2)–1. Further, a new comment 19(a)(2)–2 clarifies that where corrected disclosures are required consummation may not occur until both the seven-business-day waiting period and the three-business-day waiting period have expired.

Seven-business-day waiting period for early disclosures. The final rule (like the proposal) provides that the seven-business-day waiting period begins when the creditor delivers or places the early disclosures in the mail—not when the consumer receives or is deemed to receive the early disclosures. *See* comment 19(a)(2)(i)–1. This is consistent with the statutory language of the MDIA. The final rule applies the more precise definition of "business day" to the seven-business-day waiting period. Proposed comment 19(a)(1)(i)–6 clarified that consummation may occur any time on the seventh business day following delivery or mailing and provided examples to facilitate compliance. That commentary has been revised to reflect the use of the more precise definition of "business day" and redesignated as new comment 19(a)(2)(i)–1.

Three-business-day waiting period for corrected disclosures. As proposed, the final rule provides that consummation may not occur until three business days after the consumer receives corrected disclosures required by § 226.19(a)(2)(ii). This is consistent with the MDIA and is also consistent with the three-business-day waiting period in § 226.31(c)(1) for high-cost mortgages described in § 226.32(a) (HOEPA loans). The final rule applies the more precise definition of "business day" (all calendar days except Sundays and specified legal public holidays) to the three-business-day waiting period, as discussed below in part III.D of the SUPPLEMENTARY INFORMATION.

Also as proposed, the final rule provides that if a creditor places corrected disclosures in the mail, the consumer is deemed to receive the corrected disclosures three business days after they are mailed. Comment 19(a)(2)(ii)–3 clarifies that if the creditor provides the corrected disclosures by mail, the consumer is considered to have received them three business days after they are placed in the mail, for purposes of determining when the

three-business-day waiting period required under § 226.19(a)(2)(ii) begins. The comment also clarifies that creditors that use e-mail or a courier other than the postal service may also follow this approach. For example, if a creditor provides disclosures through a courier service, the creditor may presume that the consumer receives the disclosures three business days after they are deposited with the courier service, for purposes of determining when the three-business-day waiting period required by § 226.19(a)(2)(ii) begins. The Board is not adopting separate rules or presumptions regarding the delivery of disclosures by overnight courier, electronic transmission, or other means. Although these methods may be faster than delivery by regular mail, the Board believes that, in light of the variety of delivery methods and options offered by service providers, it is not feasible to define with sufficient clarity what may be considered acceptable "overnight delivery" or to delineate a separate time period for presumption of receipt for each available delivery method, as previously stated in the supplementary information to the Board's July 2008 final rule (*see* 73 FR at 44593; July 30, 2008).

A creditor is not required to use the presumption of receipt to determine when the waiting period required by § 226.19(a)(2)(ii) begins. Thus, if a creditor delivers corrected disclosures electronically consistent with the E-Sign Act or delivers disclosures by overnight courier, the creditor may rely on evidence of actual delivery (such as documentation that the mortgage loan disclosure was delivered by certified mail or overnight delivery or e-mail (if similar documentation is available)) to determine when the three-business-day waiting period begins.

The rules for corrected disclosures are contained in new § 226.19(a)(2)(ii). Therefore, comments 19(a)(2)–1 through 19(a)(2)–4 have been redesignated (as revised) as comments 19(a)(2)(ii)–1 through 19(a)(2)(ii)–4.

APR accuracy for corrected disclosures. New comment 19(a)(2)–4 has been added to address commenters' request for guidance in cases where corrected disclosures have been given and the APR subsequently changes. The new comment clarifies that in such cases, the creditor should compare the APR at consummation with the APR in the most recently provided corrected disclosures (not the first set of disclosures provided) to determine whether the creditor must provide another set of corrected disclosures.

Commenters requested guidance on whether corrected disclosures are required if the APR initially disclosed under § 226.19(a)(1)(i) overstates the actual APR. Comment 19(a)(2)(ii)–1 provides that corrected disclosures are not required when the APR previously disclosed is considered accurate under the tolerances in § 226.22.

D. Definition of "Business Day"—§ 226.2(a)(6)

Proposed Rule

The MDIA provides that if the early disclosures are mailed to the consumer, the consumer is considered to have received them three business days after they are mailed for purposes of the prohibition on collecting fees before the consumer receives the early disclosures. This is consistent with the July 2008 final rule (*see* 73 FR at 44600–44601; July 30, 2008). In the rulemaking to implement the MDIA, the Board proposed to adopt that same presumption for purposes of the requirement that consumers receive corrected disclosures, if necessary, not later than the third business day before consummation, as discussed above in part III.C of the **SUPPLEMENTARY INFORMATION.** In the July 2008 final rule, the Board also clarified how creditors should count weekends and Federal legal public holidays in determining when mailed disclosures are presumed to be received and how long the restriction on fees applies under § 226.19(a)(1)(ii) (*see* 73 FR at 44599; July 30, 2008). In this rulemaking, the Board proposed to further clarify that creditors should count "business days" the same way for purposes of the presumption in § 226.19(a)(2) that consumers receive corrected disclosures three business days after they are mailed.

Currently, § 226.2(a)(6) contains two definitions of "business day." Under the general definition, a "business day" is a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions. However, for some purposes a more precise definition applies; "business day" means all calendar days except Sundays and specified Federal legal public holidays, for purposes of §§ 226.15(a), 226.23(a), and 226.31(c)(1) and (2). The July 2008 final rule adopted the more precise definition for use in determining when mailed disclosures are presumed to be received under § 226.19(a)(1)(ii). The Board also proposed to apply this definition for purposes of determining when disclosures are presumed to be received for purposes of the three-business-day waiting period in § 226.19(a)(2). As explained below, this approach is being adopted in this final rule.

Under the MDIA, creditors must deliver the early disclosures, or place them in the mail, no later than three business days after receiving a consumer's application for a dwelling-secured mortgage loan; the delivery or mailing also must occur not later than the seventh business day before consummation. The Board proposed to use the general definition of "business day" for purposes of satisfying these timing requirements, both of which were contained in proposed § 226.19(a)(1)(i). This approach was consistent with RESPA's requirement that creditors provide good faith estimates of settlement costs not later than three business days after the creditor receives the consumer's application for a Federally related mortgage loan. *See* 24 CFR 3500.2(b) and 3500.7. To simplify the rule, the Board proposed that the general definition of "business day" also would be used for determining when the seven-business-day waiting period expires and consummation may occur. The Board requested comment, however, on whether the more precise definition of business day should be used to facilitate compliance with the seven-business-day waiting period requirement.

Public Comment

Many commenters addressed which definition of "business day" should apply for purposes of determining when the seven-business-day waiting period expires and consummation may occur. Most of these commenters stated that the more precise definition of "business day" under § 226.2(a)(6)—all calendar days except Sunday and specified legal public holidays—should be used for this purpose.

Several consumer advocacy organizations stated that using the more precise definition for *all* purposes under § 226.19(a) would allow creditors and supervisory agencies to determine easily whether timing requirements have been satisfied. A financial services trade association and a financial institution stated that the general definition creates uncertainty for a creditor if it has many offices, branches, and operation centers and only some of them are open on Saturdays.

Several commenters supported using the general definition of "business day" for purposes of the requirement that creditors deliver or mail the early disclosures within three business days after receiving the consumer's application, to maintain consistency

with the RESPA rules. However, these commenters supported using the more precise definition for all other timing requirements.

A financial services trade association supported using the more precise definition of "business day" for purposes of the seven-business-day waiting period so that the timing requirement would apply uniformly to all creditors, regardless of when their offices are open. A few commenters stated that using the general definition would disadvantage institutions whose offices are open only five days per week, including many community banks.

One financial institution and a realtors' trade association asserted, however, that the general definition of "business day" should be used for purposes of the seven-business-day waiting period. The realtors' trade association stated that the general definition should be used for all timing requirements to ensure consistency with RESPA, facilitate compliance, and reduce confusion for consumers. Two credit union trade associations and a financial institution stated that a single definition should be used for all timing requirements, but these commenters did not state a preference for one definition over the other.

Final Rule

As the Board proposed, the final rule requires that creditors use the general definition of "business day" to calculate the three-business-day period for providing the early disclosures. Both TILA and RESPA require creditors to provide disclosures within three business days after the creditor receives the consumer's application. Using the general definition of "business day" (a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions) will maintain consistency between the TILA and RESPA requirements.

Under the final rule, the more precise definition of "business day" (all calendar days except Sundays and specified Federal legal public holidays) is used for purposes of the requirements that creditors deliver or mail the early disclosures no later than the seventh business day before consummation and that consumers receive corrected disclosures (if applicable) no later than the third business day before consummation. The more precise definition of "business day" also is used for purposes of the rule prohibiting the collection of a fee (other than a fee for obtaining a consumer's credit history) before the consumer receives the early disclosures, under the final rule published on July 30, 2008. This is consistent with HUD's Regulation X (24 CFR 3500.7(a)(4) and 3500.7(b)(4)), which provides that if a creditor or broker mails good faith estimates of settlement costs, a consumer is considered to receive them three calendar days after they are mailed, not including Sundays and specified legal public holidays.

The Board believes that it is appropriate to use the more precise definition of "business day" for purposes of both the seven-business-day waiting period and the three-business-day waiting period, for several reasons. It is easier for a creditor to determine how to meet timing requirements using the more precise definition, especially a creditor with multiple offices that are not open on the same days. Using the more precise definition also will mean that the standard for determining when a waiting period ends is the same for all creditors. Moreover, whether a creditor's offices are open or closed does not affect the time that a consumer has to receive and review disclosures.

E. Consumer's Waiver of Waiting Period Before Consummation—§ 226.19(a)(3)

Proposed Rule

Under the MDIA, to expedite consummation of a mortgage transaction, a consumer may modify or waive the timing requirements for the early disclosures when the consumer determines that the credit extension is needed to meet a *bona fide* personal financial emergency. However, the consumer must receive the disclosures required by TILA Section 128(a), 15 U.S.C. 1638(a), at or before the time of the consumer's modification or waiver.

To implement this provision, the Board proposed to permit a consumer to shorten or waive either the seven-business-day period required by § 226.19(a)(1)(i) or the three-business-day waiting period required by § 226.19(a)(2), provided the consumer has received accurate TILA disclosures reflecting the mortgage transaction's final costs and terms. Thus, under the proposed rule, if the consumer waives the seven-business-day waiting period after receiving the early disclosures and a change occurs that makes the APR inaccurate (as determined under § 226.22), the consumer would have to receive corrected disclosures with all changed terms not later than the third business day before consummation. In such cases, the consumer could waive the three-business-day waiting period in § 226.19(a)(2) after receiving the corrected disclosures. Proposed comment 19(a)(3)–2 provided examples to facilitate compliance.

Under proposed § 226.19(a)(3), the consumer would have to give the creditor a dated written statement describing the emergency and specifically modifying or waiving the waiting period(s). The use of pre-printed forms for this purpose would be prohibited and all consumers entitled to receive the disclosures would have to sign the statement. The proposal's procedures for waiving the waiting periods were substantially similar to the existing rules for waiving the three-business-day rescission period for certain home-secured loans and the three-business-day waiting period before consummating certain high-cost mortgage loans. *See* §§ 226.15(e), 226.23(e), and 226.31(c)(1)(iii). The Board solicited comment on whether the proposed rule should be more or less flexible than the existing procedures.

The Board proposed comment 19(a)(3)–1 to clarify that a consumer may modify or waive the required waiting period(s) only if the consumer has a *bona fide* personal financial emergency that must be met before the end of the waiting period(s). This proposed comment was designed to be consistent with the commentary on waiving the rescission period and the pre-consummation waiting period required for certain high-cost mortgage loans. *See* comments 15(e)–1, 23(e)–1, and 31(c)(1)(iii)–1. The proposed comment explained that whether a *bona fide* personal financial emergency exists would be determined by the facts surrounding individual situations. The imminent sale of the consumer's home at foreclosure during the three-business-day waiting period was provided as an example, and the Board solicited comment on whether there are other circumstances that should be expressly recognized in the final rule.

Public Comment

Consumer advocacy organizations generally stated that modification or waiver of a waiting period should be permitted only in narrow circumstances, such as an imminent foreclosure, tax, or condemnation sale. Many financial institutions and financial services trade associations stated that much flexibility is needed to accommodate consumers who want to expedite consummation. A credit union association stated that the "financial emergency" exception should be available only in unusual and unforeseeable financial circumstances, however.

Copyright © 2009 Association of Corporate Counsel

Waiver of either waiting period. Consumer advocacy organizations stated that the final rule should permit consumers to waive or modify only the seven-business-day waiting period and asserted that the MDIA does not allow consumers to waive or modify the three-business-day waiting period. They asserted that a *bona fide* personal financial emergency seldom would arise unexpectedly after the creditor makes early disclosures and before consummation. Consumer advocates also stated that even if waiver of the three-business-day waiting period is permitted in some circumstances, it should not be permitted when the consumer already has waived the seven-business-day waiting period. They noted that consumers must receive "final disclosures" before waiving the seven-business-day waiting period and stated that the Board should interpret the MDIA to prohibit changes in APR after a creditor provides these disclosures and obtains the consumer's signed waiver. Thus, under their interpretation of the statute, corrected disclosures and a new three-business-day waiting period would be unnecessary.

Few of the financial institutions and financial services trade associations specifically discussed waiver of the three-business-day waiting period after a consumer receives corrected disclosures, but those that did address the issue supported allowing such waiver. A financial institution stated that, in cases where the creditor provides corrected disclosures, the consumer's previous waiver of the seven-business-day waiting period under § 226.19(a)(3) automatically should waive the three-business-day waiting period as well.

Waiver procedures and conditions. Consumer advocacy organizations supported the waiver procedures as proposed and stated that the waiver should be handwritten, to prevent consumers from unwittingly signing a creditor's pre-printed waiver forms. On the other hand, two financial institutions stated that waiver using pre-printed forms should be permitted. One financial institution recommended clarifying whether each consumer primarily liable on the obligation should sign the written waiver, even though under § 226.17(d) a creditor need only provide the disclosures to one of the consumers who is primarily liable on the obligation. A consumer advocacy organization urged the Board to require creditors to give early disclosures to all of the consumers who will be obligated on a mortgage transaction. By contrast, a financial services trade association stated that creditors should be allowed to accept a waiver from one consumer, even where multiple consumers will be obligated on the loan.

Most financial institutions and financial services trade associations stated that the final rule should specify that creditors do not have to investigate a consumer's determination that the credit extension is needed to meet a *bona fide* personal financial emergency. Two financial institutions stated that the Board should allow consumers to waive a waiting period even when a *bona fide* personal financial emergency does not have to be met during the waiting period. A credit union stated that the Board should allow consumers to waive a waiting period where a *bona fide* personal financial emergency must be satisfied within a few days after the waiting period, for example, where a consumer facing imminent foreclosure must make payments before the actual date of a foreclosure sale. Most consumer advocacy organizations opposed allowing waiver unless a *bona fide* personal financial emergency must be met during the waiting period.

Examples of a bona fide personal financial emergency. Proposed comment 19(a)(3)–1 states that the imminent sale of a consumer's home at foreclosure during the waiting period is an example of a *bona fide* personal financial emergency. This example is consistent with commentary on waiving a pre-consummation waiting period that is required for HOEPA loans under § 226.31(c)(1)(iii). Most of the financial institutions and financial services trade associations that discussed this commentary stated that the Board should provide additional guidance on when waiver is permitted and how it may be accomplished. Several of these commenters stated that without such guidance, creditors will rarely, if ever, allow a consumer to waive a waiting period. Most of these commenters stated that the final rule should provide additional examples of circumstances that are considered to be a *bona fide* personal financial emergency. Two financial services trade associations stated that the Board should clarify that any examples are merely illustrative and that a *bona fide* personal financial emergency may exist in other circumstances. Two financial services trade associations stated that the final rule should permit a consumer to waive a waiting period to avoid a foreclosure on a dwelling occupied by tenants.

Several financial institutions and financial services trade associations stated that consumers should be able to waive a waiting period if they plan to use the loan proceeds to pay a tuition expense. On the other hand, a credit union association stated that tuition expenses should not be considered to be a *bona fide* personal financial emergency, especially if the payment deadline was known well in advance. Other circumstances that commenters stated should be considered as a *bona fide* personal financial emergency included cases where a borrower needs to: pay an emergency medical expense; consummate a transaction before an upcoming increase in a land transfer tax; make repairs after a natural disaster to prevent additional property damage; obtain a refinance loan before a payment increase on an adjustable-rate mortgage; and avoid paying a late charge on an existing obligation.

Final Rule

The Board is adopting § 226.19(a)(3) substantially as proposed, which is consistent with Regulation Z's existing provisions for waiving the three-business-day right of rescission for certain mortgage transactions. Under the final rule, if a consumer determines that an extension of credit is needed to meet a *bona fide* personal financial emergency, the consumer may shorten or waive the seven business-day waiting period or the three-business-day waiting period required by § 226.19(a)(2) after the consumer receives accurate TILA disclosures that reflect the final costs and terms. To shorten or waive a waiting period, the consumer must give the creditor a dated written statement that describes the emergency, specifically modifies or waives the waiting period, and bears the signature of all the consumers who will be primarily liable on the legal obligation. Creditors may not use pre-printed forms for this purpose.

Waiver of either waiting period. The final rule permits consumers to waive either the seven-business-day or the three-business-day waiting period and thus recognizes that a *bona fide* personal financial emergency could occur at any time, including after the consumer receives the initial early disclosures. For example, a consumer might receive the initial early disclosures with the expectation of closing the loan within 60 days. However, the consumer's financial circumstances might change in the interim, creating a need to consummate the loan immediately. Under the final rule, if the APR stated in the early disclosures is no longer accurate, after receiving a corrected disclosure the consumer can provide a signed statement describing the financial emergency in order to waive the three-business-day waiting period and close

Copyright © 2009 Association of Corporate Counsel

the loan. New comment 19(a)(3)–3 illustrates the case where a consumer does not modify or waive the seven-business-day waiting period but modifies the three-business-day waiting period, after receiving a corrected disclosure.

Consumer advocates asserted that the MDIA does not provide for waiver of the three-business-day waiting period. The Board disagrees with that interpretation of the statute. Under the MDIA, consumers may waive or modify the timing requirements (and thus the waiting periods) for the disclosures required under TILA Section 128(b)(2)(A). The Board interprets this provision in the MDIA to apply to the "good faith estimates" provided under section 128(b)(2)(A)—whether they are the creditor's initial early disclosures or a corrected version provided subsequently. The requirement in TILA Section 128(b)(2)(D) for a creditor to provide a corrected disclosure is essentially a requirement for the creditor to provide an additional set of the early disclosures required by TILA Section 128(b)(2)(A).

Consumer advocates further asserted that even if the Board determines that the three-business-day waiting period can be waived in some circumstances, consumers should not be permitted to waive the three-business-day waiting period if they have previously waived the seven-business-day waiting period. In their view, once a consumer receives the initial early disclosures and waives the seven-business-day waiting period, the APR may not be changed, even though the transaction has not been consummated. The consumer advocates note that under the MDIA consumers can waive the seven-business-day waiting period only after they receive "final" TILA disclosures. The Board does not agree with the consumer advocates' interpretation of the statute. The MDIA seeks to ensure that a consumer's decision to waive the waiting period and immediately consummate the loan is informed by an accurate "final" TILA disclosure. There is no indication, however, that the Congress intended to make the rate or other terms stated in the disclosures binding on the parties. Although creditors must provide an accurate "final" disclosure before the consumer waives the seven-business-day waiting period and consummates the loan, providing such a disclosure by itself does not assure that the APR (or other loan terms) cannot change. Thus, if the APR subsequently increases by more that the specified tolerance, the consumer's previous waiver is no longer effective and a new "final" disclosure must be given. After receiving the new "final" disclosure, a consumer may decide whether to provide another signed waiver statement.

Waiver procedures and conditions. The final rule requires that waivers be written, not pre-printed, consistent with regulatory requirements for waiver of a rescission period or of the waiting period before consummation of a HOEPA loan. The Board is revising comment 19(a)(3)–1 to clarify that each consumer who will be primarily liable on the legal obligation must sign the written statement, in order for a waiver to be effective. The MDIA states that a waiver statement "shall bear the signature of all consumers entitled to receive the disclosures required by" TILA Section 128(b), 15 U.S.C. 1638(b), and proposed comment 19(a)(3)–1 contained similar language. However, in a transaction where multiple consumers are primarily liable on the legal obligation, a creditor may provide disclosures to one of those consumers rather than to all of them. TILA Section 121(a), 15 U.S.C. 1631(a); 12 CFR 226.17(d). To avoid confusion, the Board has revised comment 19(a)(3)–1 to provide that a statement that shortens or waives a pre-consummation waiting period must be signed by each consumer who is primarily liable on the legal obligation. This is consistent with, yet more specific than, comment 23(e), which states that a waiver statement must be signed by each consumer entitled to rescind, and comment 31(c)(iii)–1, which states that a waiver statement must be signed by each consumer entitled to the waiting period for HOEPA loans.

Some commenters requested that the Board adopt a comment stating that the existence of a consumer's waiver insulates a creditor from liability in connection with such waiver. The Board is not adopting such commentary. Comments 15(e)–1 and 23(e)–1 state that the existence of a consumer's waiver will not, of itself, automatically insulate the creditor from liability for failing to provide the right of rescission. The Board expects to consider Regulation Z's modification and waiver rules for the MDIA, rescission, and HOEPA in connection with its broader review of regulations for closed-end consumer credit.

Some commenters suggested that consumers may need to obtain the loan proceeds during the waiting period to prevent an emergency, such as foreclosure, that will not occur until after the waiting period. For example, if a foreclosure sale is scheduled to occur a few days after a waiting period ends, a consumer may need to obtain funds within the waiting period to reinstate the mortgage before the date of the scheduled foreclosure sale. However, the longer the period before an adverse event will occur, the less likely it is that consummation actually needs to occur during the waiting period to avoid the adverse event.

Example of a bona fide personal financial emergency. Comment 19(a)(3)–1 has been revised to clarify that consumers who need to obtain the funds during the waiting period may execute the waiver in such cases. The example stated in comment 19(a)(3)–1 is merely illustrative; a consumer may determine that a credit extension is necessary to meet a *bona fide* personal financial emergency in circumstances other than foreclosure. The Board believes that it is not necessary to state additional examples of a *bona fide* personal financial emergency at this time. Whether credit must be extended before a waiting period expires, in order to meet a *bona fide* personal financial emergency, is determined based on the facts associated with individual situations, as comment 19(a)(3)–1 states. The Board believes waivers should not be used routinely to expedite consummation for reasons of convenience. As the MDIA requires, under the final rule a waiver statement must be written by the consumer. As proposed, the final rule prohibits the use of pre-printed forms to further protect against routine modification or waiver of the waiting periods.

F. Notice—§ 226.19(a)(4)

Proposed Rule

The MDIA requires that the early disclosures contain a clear and conspicuous notice containing the following statement: "You are not required to complete this agreement merely because you have received these disclosures or signed a loan application." The Board proposed to implement this requirement in a new § 226.19(a)(4), for the early disclosures required by § 226.19(a)(1)(i), as well as any corrected disclosures required by § 226.19(a)(2). The Board solicited comment on the costs and benefits of the proposed rule. The Board also solicited comment on the language used in the disclosures and whether other language might be easier for consumers to understand.

Public Comment

Consumer advocacy organizations stated that the Board should not alter the statutory language without a compelling reason. These commenters noted that the statutory text for the

Copyright © 2009 Association of Corporate Counsel

Federal Register / Vol. 74, No. 95 / Tuesday, May 19, 2009 / Rules and Regulations 23297

notice is almost identical to the statutory text for the notice required for HOEPA loans. Two financial services trade associations and a financial institution stated that using the phrase "this agreement" in the required statement would mislead consumers, because the disclosures are not in fact an agreement. Several industry commenters recommended that the Board publish model forms or clarify how creditors can make the disclosure in "conspicuous type size and format." A credit union trade association stated that the MDIA's notice requirements would not benefit consumers but would increase financial institutions' costs considerably.

A financial institution stated that many creditors routinely provide new disclosures under § 226.18 to the consumer on the day of consummation, even where the creditor is not required to provide corrected disclosures. The bank stated that such "final" disclosures should be permitted to contain the statement required by § 226.19(a)(4) so that creditors may use a single form.

Final Rule

The Board is adopting § 226.19(a)(4) as proposed using the text contained in the statute. The statement required by § 226.19(a)(4) must be grouped together with the other disclosures required by § 226.19(a)(1) and § 226.19(a)(2). Most creditors provide TILA disclosures at consummation, even if the early disclosures remain accurate and corrected disclosures are not required. To facilitate compliance for creditors that use the same form for the initial disclosures and final disclosures, new comment 17(a)(1)–5(xvi) clarifies that creditors may also include the notice described in § 226.19(a)(4) on the disclosures provided at consummation and may group the notice together with the disclosures required by § 226.18.

The Board believes that the reference to an "agreement" is sufficiently clear as a reference to the loan agreement that the disclosures summarize. The Board is not proposing new model disclosures at this time because the Board anticipates proposing new model disclosure forms and clauses during 2009, in connection with consumer testing and the comprehensive review of closed-end mortgage disclosures that currently is underway.

G. Timeshare Transactions—§ 226.19(a)(5)

Proposed Rule

The Board proposed a new § 226.19(a)(5) containing the early disclosure requirements for mortgage loans secured by a consumer's interest in a "timeshare plan" (timeshare transactions), as defined in the bankruptcy laws (*see* 11 U.S.C. 101(53D)). Pursuant to amendments in the Stabilization Act, the disclosure timing requirements and the fee restriction added by the MDIA are not applicable to timeshare transactions, which instead are subject to the same disclosure timing requirements that applied to "residential mortgage transactions" under TILA Section 128(b)(2), 15 U.S.C. 1638(b), before the MDIA was enacted. Accordingly, for timeshare transactions, proposed § 226.19(a)(5) required that creditors make good faith estimates of the disclosures required by § 226.18 that must be delivered or placed in the mail within three business days after the creditor receives the consumer's application or before the credit is extended, whichever is earlier. The seven-business-day waiting period and three-business-day waiting period before consummation contained in § 226.19(a)(2) do not apply to timeshare transactions.

For timeshare transactions, if the APR stated in the early disclosures changes beyond the specified tolerance, under proposed § 226.19(a)(5)(iii), creditors would have to disclose all the changed terms no later than consummation or settlement of the transaction, consistent with the existing rules for residential mortgage transactions in § 226.19(a)(2). Currently, comment 19(a)(2)–3 states that "consummation" is defined in § 226.2(a), and "date of settlement" is defined in HUD's Regulation X (24 CFR 3500.2(a)). As discussed above, for transactions other than timeshare transactions, the MDIA amends TILA to remove reference to "settlement" from TILA's provisions requiring creditors to make corrected disclosures.

The Board solicited comment on the costs and benefits of basing the timing for corrected disclosures on the time of consummation or settlement for timeshare transactions but solely on the time of consummation for other mortgage loans. The Board asked whether Regulation Z's timing requirements for corrected disclosures should be made consistent for all closed-end mortgage transactions by requiring creditors to make corrected disclosures at the time of consummation for timeshare transactions. The Board also asked, in the alternative, whether Regulation Z should require creditors to make corrected disclosures three business days before consummation or settlement, whichever is later, for closed-end mortgage loans other than timeshare transactions.

Public Comment

Most consumer advocacy organizations stated that corrected disclosures for all mortgage loans other than timeshare transactions should be provided before consummation, which marks the time when the consumer's legal obligation begins. These commenters stated that allowing corrected disclosures to be given at the time of settlement would be less advantageous for consumers, because they would be obligated on the transaction before they received the corrected disclosures. They recommended that the same rules should apply to timeshare transactions as well. A community bank trade association stated that the disclosure timing requirements for timeshare transactions should be the same as for other closed-end mortgage transactions, to facilitate compliance with Regulation Z.

Final Rule

The Board is adopting § 226.19(a)(5) as proposed. The final rule, like the proposed rule, tracks the MDIA's requirements for timeshare transactions in TILA Section 128(b)(2)(G), as amended. In particular, under § 226.19(a)(5)(iii), if the APR stated in the early disclosures becomes inaccurate, the creditor must disclose all the changed terms no later than consummation *or* settlement. By contrast, for loans other than timeshare transactions, the creditor must make corrected disclosures (if required) not later than the third business day before consummation, which conforms with TILA Section 128(b)(2)(D), as added by the MDIA.

For timeshare transactions, the general definition of "business day" (days the creditor's offices are open to the public for carrying on substantially all of its business functions) is used for purposes of § 226.19(a)(5)(ii), as proposed. This is consistent with the rules for providing early disclosures for other types of mortgage transactions. Also, the commentary accompanying § 226.19(a)(5) has been revised for clarity.

H. Solicitation of Comments on Timing of Disclosures for Home Equity Lines of Credit

The MDIA applies only to closed-end loans secured by a consumer's dwelling and does not affect the disclosure requirements for open-end credit plans secured by a dwelling (home equity lines of credit, or HELOCs). In connection with the Board's comprehensive review of Regulation Z,

Copyright © 2009 Association of Corporate Counsel

the Board's staff is currently reviewing the content and format of HELOC disclosures and subjecting them to consumer testing. To aid in this review, the Board sought comment on whether it is necessary or appropriate to change the timing of HELOC disclosures and, if so, what changes should be made. The Board is considering the comments received and anticipates issuing a proposal to improve the disclosures later in 2009.

I. Effective Date

This final rule becomes effective on July 30, 2009, consistent with the requirements of the MDIA. The provisions in TILA Section 105(d), 15 U.S.C. 1604(d), regarding the effective date of new disclosure requirements is superseded by the effective date of the MDIA.

Many financial institutions and financial services trade associations stated that the final rules implementing the MDIA should apply only to mortgage transactions for which creditors receive the consumer's application on or after July 30, 2009. The final rule adopts this approach, which is consistent with comment 1(d)(5)–1, contained in the July 2008 final rule.

The Board is adopting new comment 1(d)(3)–1 to facilitate compliance by specifying which provisions of the July 2008 final rule will become effective on July 30, 2009 as revised by this final rule. Compliance with those provisions, as revised, is mandatory for covered loans for which the creditor receives an application on or after July 30, 2009. The specific amended subsections are §§ 226.2(a)(6), 226.17(b) and (f), and 226.19(a)(1) through (a)(5). Covered loans include refinance loans and assumptions that are considered to be new transactions under § 226.20(a) or (b).

IV. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3506; 5 CFR Part 1320 Appendix A.1), the Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The collection of information that is required by this final rule is found in 12 CFR part 226. The Board may not conduct or sponsor, and an organization is not required to respond to, this information collection unless the information collection displays a currently valid OMB control number. The OMB control number is 7100–0199.

This information collection is required to provide benefits for consumers and is mandatory (15 U.S.C. 1601 *et seq.*). Since the Board does not collect any information, no issue of confidentiality arises. The respondents/recordkeepers are creditors and other entities subject to Regulation Z, including for-profit financial institutions and small businesses.

TILA and Regulation Z are intended to ensure effective disclosure of the costs and terms of credit to consumers. For closed-end loans, such as mortgage and installment loans, cost disclosures are required to be provided prior to consummation. Special disclosures are required in connection with certain products, such as reverse mortgages, certain variable-rate loans, and certain mortgages with rates and fees above specified thresholds. TILA and Regulation Z also contain rules concerning credit advertising. Creditors are required to retain evidence of compliance for twenty-four months (§ 226.25), but Regulation Z does not specify the types of records that must be retained.

Under the PRA, the Board accounts for the paperwork burden associated with Regulation Z for the state member banks and other creditors supervised by the Board that engage in lending covered by Regulation Z and, therefore, are respondents under the PRA. Appendix I of Regulation Z defines the institutions supervised by the Federal Reserve System as: state member banks, branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act. Other Federal agencies account for the paperwork burden imposed on the entities for which they have administrative enforcement authority under TILA. To ease the burden and cost of complying with Regulation Z (particularly for small entities), the Board provides model forms, which are appended to the regulation.

As discussed above, on December 10, 2008, the Board published in the **Federal Register** a notice of proposed rulemaking to implement the MDIA (73 FR 74989). The comment period for this notice expired February 9, 2009. The Board received two comment letters from banks that specifically addressed paperwork burden. The commenters asserted that the hourly estimate of the cost of compliance should be considerably higher than the Board projected. The commenters noted that, in addition to updating their systems and internal procedure manuals, compliance would require additional staff training but did not provide specific estimates of additional burden hours that would result from the proposal. In response to those comments, the Board is increasing the burden estimate attributable to additional staff training and updates to internal procedures.

Based on this adjustment to the estimate published in the proposed rule the Board estimates that each of the 1,138 respondents supervised by the Federal Reserve System would take, on average, 40 hours (one business week) to update their systems, provide additional staff training, and update internal procedures to comply with the proposed disclosure requirements in §§ 226.17 and 226.19. This one-time revision would increase the burden for the respondents supervised by the Federal Reserve System by 45,520 hours from 688,607 hours to 734,127 hours.

The total estimated burden increase represents averages for all respondents supervised by the Federal Reserve System. The Board expects that the amount of time required to implement each of the changes for a given institution may vary based on the size and complexity of the respondent.

The other Federal financial institution supervisory agencies (the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA)) are responsible for estimating and reporting to OMB the total paperwork burden for the domestically chartered commercial banks, thrifts, and Federal credit unions and U.S. branches and agencies of foreign banks for which they have primary administrative enforcement jurisdiction under TILA Section 108(a), 15 U.S.C. 1607(a). These agencies may, but are not required to, use the Board's burden estimation methodology. Using the Board's method, the total current estimated annual burden for the approximately 17,200 domestically chartered commercial banks, thrifts, and Federal credit unions and U.S. branches and agencies of foreign banks supervised by the Board, OCC, OTS, FDIC, and NCUA under TILA would be approximately 13,568,725 hours. The final rule will impose a one-time increase in the estimated annual burden for such institutions by 688,000 hours to 14,256,725 hours. The above estimates represent an average across all respondents and reflect variations between institutions based on their size, complexity, and practices.

The Board has a continuing interest in the public's opinions of its collections of information. At any time, comments

regarding the burden estimate or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project (7100–0199), Washington, DC 20503.

V. Final Regulatory Flexibility Analysis

In accordance with section 4 of the Regulatory Flexibility Act (RFA), 5 U.S.C. 601–612, the Board is publishing a final regulatory flexibility analysis for the proposed amendments to Regulation Z. The RFA generally requires an agency to perform an assessment of the impact a rule is expected to have on small entities.[2] However, under Section 605(b) of the RFA, 5 U.S.C. 605(b), the regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if an agency certifies that the rule will not have a significant economic impact on a substantial number of small entities and states the factual basis for such certification. The Board continues to believe that this final rule will not have a significant economic impact on a substantial number of small entities. The final amendments to Regulation Z are narrowly designed to implement the revisions to TILA made by the MDIA. Creditors must comply with the MDIA's requirements when they become effective on July 30, 2009, whether or not the Board amends Regulation Z to conform the regulation to the statute. The Board's final rule is intended to facilitate compliance by eliminating inconsistencies between Regulation Z's existing requirements and the statutory requirements imposed by the MDIA starting July 30, 2009.

A. Statement of the Need for, and Objectives of, the Final Rule

Congress enacted the TILA based on findings that economic stability would be enhanced and competition among consumer credit providers would be strengthened by the informed use of credit resulting from consumers' awareness of the cost of credit. One of the stated purposes of TILA is to provide a meaningful disclosure of credit terms to enable consumers to compare credit terms available in the marketplace more readily and avoid the uninformed use of credit. TILA also contains procedural and substantive protections for consumers. TILA directs the Board to prescribe regulations to carry out the purposes of the statute. The Board's Regulation Z implements TILA.

Congress enacted the MDIA in 2008 as an amendment to TILA. The MDIA amends TILA's disclosure requirements for closed-end mortgage transactions that are secured by a consumer's dwelling and subject to the Real Estate Settlement Procedures Act (RESPA). In July 2008, the Board revised Regulation Z to expand the number of transactions in which creditors must give a good faith estimate of the required disclosures (early disclosures). Previously, early disclosures were required only for loans made to finance the purchase or initial construction of a consumer's principal dwelling. Under the July 2008 final rule, creditors must provide early disclosures for any mortgage loan secured by the consumer's principal dwelling, such as a home refinance loan or home equity loan. The MDIA amends TILA to require early disclosures for consumer loans secured by any dwelling, even if it is not the consumer's principal dwelling. As explained in parts I and III of the **SUPPLEMENTARY INFORMATION**, the MDIA and the Board's final rule require creditors to delay consummating a loan for seven business days after the creditor makes early disclosures, and three business days after the consumer receives any required corrected disclosures.

B. Summary of Issues Raised by Comments in Response to the Initial Regulatory Flexibility Analysis

Parts I and III of the **SUPPLEMENTARY INFORMATION** contain a detailed discussion of the objectives and legal basis for this final rulemaking. In summary, the amendments to Regulation Z are designed to implement changes that the MDIA makes to TILA. The legal basis for the final rule is in Section 105(a) of TILA.

In connection with the proposed rule to implement the MDIA, the Board sought information and comment on any costs, compliance requirements, or changes in operating procedures arising from the application of the rule to small institutions. The Board received several comments from small banks and trade associations that represent small banks. The commenters asserted that compliance with a final rule to implement the MDIA would increase costs and delay consummation of loans secured by a consumer's dwelling and subject to RESPA. However, these comments did not contain specific information about costs that will be incurred or changes in operating procedures that will be required to comply with the final rule. In general, the comments discussed the impact of statutory requirements rather than any impact that the Board's proposed rule itself would generate. The Board continues to believe that this final rule will not have a significant impact on a substantial number of small entities.

C. Description and Estimate of Small Entities to Which the Final Rule Will Apply

The final regulations will apply to all institutions and entities that engage in closed-end, dwelling-secured lending that is for consumer purposes and subject to RESPA. TILA and Regulation Z have broad applicability to individuals and businesses that originate even small numbers of home-secured loans. *See* § 226.1(c)(1). As discussed in the initial Regulatory Flexibility Analysis, through data from Reports of Condition and Income (Call Reports) of depository institutions and certain subsidiaries of banks and bank holding companies, as well as data reported under the Home Mortgage Disclosure Act (HMDA),[3] the Board can estimate the approximate number of small depository institutions that would be subject to the rules. For the majority of HMDA respondents that are not depository institutions, exact asset size information is not available, although the Board has estimates based on self-reporting from approximately five percent of the non-depository respondents.

Based on the best information available, the Board makes the following estimate of small entities that would be affected by this final rule: According to December 2008 Call Report data, approximately 9,418 small depository institutions would be subject to the rule. Approximately 16,648 depository institutions in the United States filed Call Report data, approximately 12,034 of which had total domestic assets of

---

[2] Under standards the U.S. Small Business Administration sets (SBA), an entity is considered "small" if it has $175 million or less in assets for banks and other depository institutions; and $6.5 million or less in revenues for non-bank mortgage lenders, mortgage brokers, and loan servicers. U.S. Small Business Administration, Table of Small Business Size Standards Matched to North American Industry Classification System Codes, *available at http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_sstd_tablepdf.pdf.*

[3] HMDA requires lenders to report information annually to their federal supervisory agencies for each application and loan acted on during the calendar year. *See* 12 U.S.C. 2801 *et seq.* The loans reported are estimated to represent about 80 percent of all home lending nationwide and therefore are likely to be broadly representative of home lending in the United States. Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, *The 2007 HMDA Data*, 84 Federal Reserve Bulletin A107, A107 (Dec. 2008) (*2007 HMDA Data*), *http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07final.pdf.*

Copyright © 2009 Association of Corporate Counsel

$175 million or less and thus were considered small entities for purposes of the RFA. Of the 4,230 banks, 564 thrifts, 7,111 credit unions, and 129 branches of foreign banks that filed Call Report data and were considered small entities, 4,090 banks, 529 thrifts, 4,796 credit unions, and 3 branches of foreign banks, totaling 9,418 institutions, extended mortgage credit. For purposes of this Call Report analysis, thrifts include savings banks, savings and loan entities, co-operative banks and industrial banks. Further, 1,752 non-depository institutions (independent mortgage companies, subsidiaries of a depository institution, or affiliates of a bank holding company) filed HMDA reports in 2008 for 2007 lending activities.[4] Based on the small volume of lending activity reported by these institutions, most are likely to be small entities.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The compliance requirements of the final rule are described in parts I and III of the SUPPLEMENTARY INFORMATION. To comply with the revised rules, many small entities will be required to modify their procedures for making credit disclosures for dwelling-secured mortgage loans. The precise costs to small entities of updating their systems and disclosures are difficult to predict. These costs will depend on a number of unknown factors, including, among other things, the specifications of the current systems used by such entities to prepare and provide disclosures.

E. Steps Taken To Minimize the Economic Impact on Small Entities

As discussed in part III of the SUPPLEMENTARY INFORMATION, TILA and RESPA both require disclosures for dwelling-secured loans that must be given within three business days of application. Under Regulation Z, the Board has interpreted TILA's timing requirement to be consistent with the timing of RESPA disclosures. Thus, where possible, the Board has made terms and definitions used in Regulation Z consistent with those terms as they are used in HUD's Regulation X. For example, Regulation Z provides that creditors may rely on RESPA and Regulation X (including any interpretations issued by HUD) in deciding whether a "written application" has been received. As a further example, the definition of "business day" that is used under the Board's final rule for purposes of requirements for a creditor to deliver or mail good faith estimates of loan terms (also known as the "early disclosures") within three business days after the creditor receives a consumer's application is consistent with the "business day" definition used under Regulation X for purposes of requirements for creditors to provide good faith estimates of settlement charges within three business days after the creditor receives the consumer's application. Many creditors send the good faith estimates required by Regulation Z and Regulation X together; these creditors may continue to send these disclosures together, under the Board's final rule. Moreover, under both Regulation Z and Regulation X, creditors count all calendar days except Sundays and specified legal holidays to determine when a consumer is considered to have received disclosures provided by means other than delivery in person. Using common definitions for terms that apply under both Regulation Z and Regulation X reduces the impact of the MDIA on all creditors, including small creditors.

The Board has made one change in the final rule that further reduces the impact of the MDIA's amendments to TILA on small creditors and other creditors. The MDIA adds two pre-consummation waiting periods—one of seven business days after the creditor delivers the early disclosures, and the other of three business days after a consumer receives corrected disclosures, if any are required—to TILA's requirements. Under the Board's final rule, the same definition of "business day" is used for purposes of each waiting period. Further, the definition of "business day" that will apply for purposes of determining when a waiting period expires and consummation may occur is an objective definition: all calendar days except Sundays and specified legal public holidays. The Board is not adopting its proposal to apply Regulation Z's general definition of "business day" (days on which the creditor's offices are open to the public for carrying on substantially all of its business functions), for purposes of this requirement. Under the Board's proposal, creditors whose offices are open seven days per week would be able to consummate mortgage transactions that are subject to the MDIA sooner than creditors whose offices are open fewer days per week. This will not be the case under the final rule. To the extent that small creditors' offices are less likely than large creditors' offices to be open on Saturday or Sunday, the final rule creates parity between small and large entities by applying the more precise definition of "business day" for purposes of determining when the seven-business-day waiting period expires and consummation may occur.

This regulatory flexibility analysis does not discuss alternatives to the final rule because the Board is revising Regulation Z for the narrow purpose of carrying out its statutory mandate to implement statutory amendments to TILA.

List of Subjects in 12 CFR Part 226

Advertising, Consumer protection, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Truth in lending.

Authority and Issuance

For the reasons set forth in the preamble, the effective date for the amendments to 12 CFR 226.2(a)(6), 226.17(b) and (f), and 226.19(a)(1), and, in Supplement I (Official Staff Interpretations) to part 226, under *Section 226.1 Authority, Purpose, Coverage, Organization, Enforcement and Liability*, under *Section 226.2 Definitions and Rules of Construction*, under *Section 226.17 General Disclosure Requirements*, and under *Section 226.19 Certain Residential Mortgage and Variable-Rate Transactions*, published on July 30, 2008 (73 FR 44600), previously October 1, 2009, is now July 30, 2009; and the Board amends Regulation Z, 12 CFR part 226 further, as set forth below:

PART 226—TRUTH IN LENDING (REGULATION Z)

■ 1. The authority citation for part 226 continues to read as follows:

Authority: 12 U.S.C. 3806; 15 U.S.C. 1604, and 1637(c)(5).

Subpart A—General

■ 2. Section 226.2 is amended by revising paragraph (a)(6) to read as follows:

§ 226.2 Definitions and rules of construction.

(a) * * *

(6) *Business Day* means a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions. However, for purposes of rescission under §§ 226.15 and 226.23, and for purposes of § 226.19(a)(1)(ii), § 226.19(a)(2), and § 226.31, the term means all calendar days except Sundays and the legal public holidays specified in 5 U.S.C. 6103(a), such as New Year's Day, the Birthday of Martin Luther King, Jr., Washington's Birthday, Memorial Day,

[4] *2007 HMDA Data* at A109 and tbl. 2.

Federal Register / Vol. 74, No. 95 / Tuesday, May 19, 2009 / Rules and Regulations 23301

Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day.

* * * * *

Subpart C—Closed-End Credit

■ 3. Section 226.17 is amended by revising paragraph (f) to read as follows:

§ 226.17 General disclosure requirements.

* * * * *

(f) *Early disclosures.* If disclosures required by this subpart are given before the date of consummation of a transaction and a subsequent event makes them inaccurate, the creditor shall disclose before consummation (subject to the provisions of § 226.19(a)(2) and § 226.19(a)(5)(iii)):[39]

(1) Any changed term unless the term was based on an estimate in accordance with § 226.17(c)(2) and was labelled an estimate;

(2) All changed terms, if the annual percentage rate at the time of consummation varies from the annual percentage rate disclosed earlier by more than 1/8 of 1 percentage point in a regular transaction, or more than 1/4 of 1 percentage point in an irregular transaction, as defined in § 226.22(a).

* * * * *

■ 4. Section 226.19 is amended by revising paragraph (a) to read as follows:

§ 226.19 Certain mortgage and variable-rate transactions.

(a) *Mortgage transactions subject to RESPA—(1)(i) Time of disclosures.* In a mortgage transaction subject to the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) that is secured by the consumer's dwelling, other than a home equity line of credit subject to § 226.5b or mortgage transaction subject to paragraph (a)(5) of this section, the creditor shall make good faith estimates of the disclosures required by § 226.18 and shall deliver or place them in the mail not later than the third business day after the creditor receives the consumer's written application.

(ii) *Imposition of fees.* Except as provided in paragraph (a)(1)(iii) of this section, neither a creditor nor any other person may impose a fee on a consumer in connection with the consumer's application for a mortgage transaction subject to paragraph (a)(1)(i) of this section before the consumer has received the disclosures required by paragraph (a)(1)(i) of this section. If the disclosures are mailed to the consumer, the consumer is considered to have received them three business days after they are mailed.

(iii) *Exception to fee restriction.* A creditor or other person may impose a fee for obtaining the consumer's credit history before the consumer has received the disclosures required by paragraph (a)(1)(i) of this section, provided the fee is *bona fide* and reasonable in amount.

(2) *Waiting periods for early disclosures and corrected disclosures.* (i) The creditor shall deliver or place in the mail the good faith estimates required by paragraph (a)(1)(i) of this section not later than the seventh business day before consummation of the transaction.

(ii) If the annual percentage rate disclosed under paragraph (a)(1)(i) of this section becomes inaccurate, as defined in § 226.22, the creditor shall provide corrected disclosures with all changed terms. The consumer must receive the corrected disclosures no later than three business days before consummation. If the corrected disclosures are mailed to the consumer or delivered to the consumer by means other than delivery in person, the consumer is deemed to have received the corrected disclosures three business days after they are mailed or delivered.

(3) *Consumer's waiver of waiting period before consummation.* If the consumer determines that the extension of credit is needed to meet a *bona fide* personal financial emergency, the consumer may modify or waive the seven-business-day waiting period or the three-business-day waiting period required by paragraph (a)(2) of this section, after receiving the disclosures required by § 226.18. To modify or waive a waiting period, the consumer shall give the creditor a dated written statement that describes the emergency, specifically modifies or waives the waiting period, and bears the signature of all the consumers who are primarily liable on the legal obligation. Printed forms for this purpose are prohibited.

(4) *Notice.* Disclosures made pursuant to paragraph (a)(1) or paragraph (a)(2) of this section shall contain the following statement: "You are not required to complete this agreement merely because you have received these disclosures or signed a loan application." The disclosure required by this paragraph shall be grouped together with the disclosures required by paragraphs (a)(1) or (a)(2) of this section.

(5) *Timeshare plans.* In a mortgage transaction subject to the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) that is secured by a consumer's interest in a timeshare plan described in 11 U.S.C. 101(53(D)):

(i) The requirements of paragraphs (a)(1) through (a)(4) of this section do not apply;

(ii) The creditor shall make good faith estimates of the disclosures required by § 226.18 before consummation, or shall deliver or place them in the mail not later than three business days after the creditor receives the consumer's written application, whichever is earlier; and

(iii) If the annual percentage rate at the time of consummation varies from the annual percentage rate disclosed under paragraph (a)(5)(ii) of this section by more than 1/8 of 1 percentage point in a regular transaction or more than 1/4 of 1 percentage point in an irregular transaction, as defined in § 226.22, the creditor shall disclose all the changed terms no later than consummation or settlement.

* * * * *

■ 5. In Supplement I to Part 226, under *Section 226.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability:*

(A) Heading *1(d) Organization* is republished;

(B) New *Paragraph 1(d)(1)* through *Paragraph 1(d)(4)* are added;

(C) Under *Paragraph 1(d)(5),* paragraph 1(d)(5)–1 is revised; and

(D) New *Paragraph 1(d)(6)* is added.

Supplement I to Part 226—Official Staff Interpretations

* * * * *

Subpart A—General

§ 226.1 Authority, Purpose, Coverage, Organization, Enforcement and Liability.

* * * * *

1(d) Organization.

Paragraph 1(d)(1)

1. [Reserved.]

Paragraph 1(d)(2)

1. [Reserved.]

Paragraph 1(d)(3)

1. *Effective date.* The Board's amendments to Regulation Z published on May 19, 2009 apply to covered loans (including refinance loans and assumptions considered new transactions under § 226.20) for which the creditor receives an application on or after July 30, 2009.

Paragraph 1(d)(4)

1. [Reserved.]

Paragraph 1(d)(5)

1. *Effective dates.* The Board's revisions published on July 30, 2008 (the "final rules") apply to covered loans (including refinance loans and

[39] [Reserved.]

Copyright © 2009 Association of Corporate Counsel

assumptions considered new transactions under § 226.20) for which the creditor receives an application on or after October 1, 2009, except for the final rules on advertising, escrows, and loan servicing. *But see* comment 1(d)(3)–1. The final rules on escrow in § 226.35(b)(3) are effective for covered loans (including refinancings and assumptions in § 226.20) for which the creditor receives an application on or after April 1, 2010; but for such loans secured by manufactured housing on or after October 1, 2010. The final rules applicable to servicers in § 226.36(c) apply to all covered loans serviced on or after October 1, 2009. The final rules on advertising apply to advertisements occurring on or after October 1, 2009. For example, a radio ad occurs on the date it is first broadcast; a solicitation occurs on the date it is mailed to the consumer. The following examples illustrate the application of the effective dates for the final rules.

i. *General.* A refinancing or assumption as defined in § 226.20(a) or (b) is a new transaction and is covered by a provision of the final rules if the creditor receives an application for the transaction on or after that provision's effective date. For example, if a creditor receives an application for a refinance loan covered by § 226.35(a) on or after October 1, 2009, and the refinance loan is consummated on October 15, 2009, the provision restricting prepayment penalties in § 226.35(b)(2) applies. However, if the transaction were a modification of an existing obligation's terms that does not constitute a refinance loan under § 226.20(a), the final rules, including for example the restriction on prepayment penalties, would not apply.

ii. *Escrows.* Assume a consumer applies for a refinance loan to be secured by a dwelling (that is not a manufactured home) on March 15, 2010, and the loan is consummated on April 2, 2010. The escrow rule in § 226.35(b)(3) does not apply.

iii. *Servicing.* Assume that a consumer applies for a new loan on August 1, 2009. The loan is consummated on September 1, 2009. The servicing rules in § 226.36(c) apply to the servicing of that loan as of October 1, 2009.

Paragraph 1(d)(6)

1. [Reserved.]

■ 6. In Supplement I to Part 226, under *Section 226.2—Definitions and Rules of Construction, 2(a) Definitions, 2(a)(6) Business day,* paragraph 2(a)(6)–2 is revised to read as follows:

§ 226.2 Definitions and Rules of Construction.

2(a) Definitions.

* * * * *

2(a)(6) Business day.

* * * * *

2. *Rule for rescission and disclosures for certain mortgage transactions.* A more precise rule for what is a business day (all calendar days except Sundays and the Federal legal holidays specified in 5 U.S.C. 6103(a)) applies when the right of rescission or the receipt of disclosures for certain dwelling-secured mortgage transactions under §§ 226.19(a)(1)(ii), 226.19(a)(2), or 226.31(c) is involved. Four Federal legal holidays are identified in 5 U.S.C. 6103(a) by a specific date: New Year's Day, January 1; Independence Day, July 4; Veterans Day, November 11; and Christmas Day, December 25. When one of these holidays (July 4, for example) falls on a Saturday, Federal offices and other entities might observe the holiday on the preceding Friday (July 3). In cases where the more precise rule applies, the observed holiday (in the example, July 3) is a business day.

* * * * *

■ 7. In Supplement I to Part 226, under *Section 226.17—General Disclosure Requirements, 17(a)(1) Form of disclosures,* new paragraph 17(a)(1)–5(xvi) is added, to read as follows:

Subpart C—Closed-End Credit

§ 226.17 General Disclosure Requirements.

17(a) Form of disclosures.

Paragraph 17(a)(1)

* * * * *

5. * * *

xvi. The notice set forth in § 226.19(a)(4), in a closed-end transaction not subject to § 226.19(a)(1)(i). In a mortgage transaction subject to § 226.19(a)(1)(i), the creditor must disclose the notice contained in § 226.19(a)(4) grouped together with the disclosures made under § 226.18. *See* comment 19(a)(4)–1.

* * * * *

■ 8. In Supplement I to Part 226, under *Section 226.19—Certain Mortgage and Variable-Rate Transactions:*

(A) Under *19(a)(1)(i) Time of disclosure,* paragraphs 19(a)(1)(i)–1 through 19(a)(1)(i)–5 are revised;

(B) *Paragraph 19(a)(2) Redisclosure required* is revised;

(C) *Paragraph 19(a)(3) Consumer's waiver of waiting period before consummation* through *Paragraph 19(a)(5)(iii) Redisclosure for timeshare plans* are added.

§ 226.19 Certain Mortgage and Variable-Rate Transactions.

19(a)(1)(i) Time of disclosure.

1. *Coverage.* This section requires early disclosure of credit terms in mortgage transactions that are secured by a consumer's dwelling (other than home equity lines of credit subject to § 226.5b or mortgage transactions secured by an interest in a timeshare plan) that are also subject to the Real Estate Settlement Procedures Act (RESPA) and its implementing Regulation X, administered by the Department of Housing and Urban Development (HUD). To be covered by § 226.19, a transaction must be a Federally related mortgage loan under RESPA. "Federally related mortgage loan" is defined under RESPA (12 U.S.C. 2602) and Regulation X (24 CFR 3500.2), and is subject to any interpretations by HUD.

2. *Timing and use of estimates.* The disclosures required by § 226.19(a)(1)(i) must be delivered or mailed not later than three business days after the creditor receives the consumer's written application. The general definition of "business day" in § 226.2(a)(6)—a day on which the creditor's offices are open to the public for substantially all of its business functions—is used for purposes of § 226.19(a)(1)(i). *See* comment 2(a)(6)–1. This general definition is consistent with the definition of "business day" in HUD's Regulation X—a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions. *See* 24 CFR 3500.2. Accordingly, the three-business-day period in § 226.19(a)(1)(i) for making early disclosures coincides with the time period within which creditors subject to RESPA must provide good faith estimates of settlement costs. If the creditor does not know the precise credit terms, the creditor must base the disclosures on the best information reasonably available and indicate that the disclosures are estimates under § 226.17(c)(2). If many of the disclosures are estimates, the creditor may include a statement to that effect (such as "all numerical disclosures except the late-payment disclosure are estimates") instead of separately labelling each estimate. In the alternative, the creditor may label as an estimate only the items primarily affected by unknown information. (*See* the commentary to § 226.17(c)(2).) The creditor may provide explanatory material concerning the estimates and the contingencies that may affect the actual terms, in accordance with the commentary to § 226.17(a)(1).

3. *Written application.* Creditors may rely on RESPA and Regulation X (including any interpretations issued by HUD) 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. *See* 24 CFR 3500.2(b). An application is received when it reaches the creditor in any of the ways applications are normally transmitted—by mail, hand delivery, or through an intermediary agent or broker. (*See* comment 19(b)–3 for guidance in determining whether or not the transaction involves an intermediary agent or broker.) If an application reaches the creditor through an intermediary agent or broker, the application is received when it reaches the creditor, rather than when it reaches the agent or broker.

4. *Denied or withdrawn applications.* The creditor may determine within the three-business-day period that the application will not or cannot be approved on the terms requested, as, for example, when a consumer applies for a type or amount of credit that the creditor does not offer, or the consumer's application cannot be approved for some other reason. In that case, or if the consumer withdraws the application within the three-business-day period, the creditor need not make the disclosures under this section. If the creditor fails to provide early disclosures and the transaction is later consummated on the original terms, the creditor will be in violation of this provision. If, however, the consumer amends the application because of the creditor's unwillingness to approve it on its original terms, no violation occurs for not providing disclosures based on the original terms. But the amended application is a new application subject to § 226.19(a)(1)(i).

5. *Itemization of amount financed.* In many mortgage transactions, the itemization of the amount financed required by § 226.18(c) will contain items, such as origination fees or points, that also must be disclosed as part of the good faith estimates of settlement costs required under RESPA. Creditors furnishing the RESPA good faith estimates need not give consumers any itemization of the amount financed.

* * * * *

19(a)(2) Waiting period(s) required.

1. *Business day definition.* For purposes of § 226.19(a)(2), "business day" means all calendar days except Sundays and the legal public holidays referred to in § 226.2(a)(6). *See* comment 2(a)(6)–2.

2. *Consummation after both waiting periods expire.* Consummation may not occur until both the seven-business-day waiting period and the three-business-day waiting period have expired. For example, assume a creditor delivers the early disclosures to the consumer in person or places them in the mail on Monday, June 1, and the creditor then delivers corrected disclosures in person to the consumer on Wednesday, June 3. Although Saturday, June 6 is the third business day after the consumer received the corrected disclosures, consummation may not occur before Tuesday, June 9, the seventh business day following delivery or mailing of the early disclosures.

19(a)(2)(i) Seven-business-day waiting period.

1. *Timing.* The disclosures required by § 226.19(a)(1)(i) must be delivered or placed in the mail no later than the seventh business day before consummation. The seven-business-day waiting period begins when the creditor delivers the early disclosures or places them in the mail, not when the consumer receives or is deemed to have received the early disclosures. For example, if a creditor delivers the early disclosures to the consumer in person or places them in the mail on Monday, June 1, consummation may occur on or after Tuesday, June 9, the seventh business day following delivery or mailing of the early disclosures.

19(a)(2)(ii) Three-business-day waiting period.

1. *Conditions for redisclosure.* If, at the time of consummation, the annual percentage rate disclosed is accurate under § 226.22, the creditor does not have to make corrected disclosures under § 226.19(a)(2). If, on the other hand, the annual percentage rate disclosed is not accurate under § 226.22, the creditor must make corrected disclosures of all changed terms (including the annual percentage rate) so that the consumer receives them not later than the third business day before consummation. For example, assume consummation is scheduled for Thursday, June 11 and the early disclosures for a regular mortgage transaction disclose an annual percentage rate of 7.00%:

i. On Thursday, June 11, the annual percentage rate will be 7.10%. The creditor is not required to make corrected disclosures under § 226.19(a)(2).

ii. On Thursday, June 11, the annual percentage rate will be 7.15%. The creditor must make corrected disclosures so that the consumer receives them on or before Monday, June 8.

2. *Content of new disclosures.* If redisclosure is required, the creditor may provide a complete set of new disclosures, or may redisclose only the changed terms. If the creditor chooses to provide a complete set of new disclosures, the creditor may but need not highlight the new terms, provided that the disclosures comply with the format requirements of § 226.17(a). If the creditor chooses to disclose only the new terms, all the new terms must be disclosed. For example, a different annual percentage rate will almost always produce a different finance charge, and often a new schedule of payments; all of these changes would have to be disclosed. If, in addition, unrelated terms such as the amount financed or prepayment penalty vary from those originally disclosed, the accurate terms must be disclosed. However, no new disclosures are required if the only inaccuracies involve estimates other than the annual percentage rate, and no variable rate feature has been added. For a discussion of the requirement to redisclose when a variable-rate feature is added, *see* comment 17(f)–2. For a discussion of redisclosure requirements in general, *see* the commentary on § 226.17(f).

3. *Timing.* When redisclosures are necessary because the annual percentage rate has become inaccurate, they must be received by the consumer no later than the third business day before consummation. (For redisclosures triggered by other events, the creditor must provide corrected disclosures before consummation. *See* § 226.17(f).) If the creditor delivers the corrected disclosures to the consumer in person, consummation may occur any time on the third business day following delivery. If the creditor provides the corrected disclosures by mail, the consumer is considered to have received them three business days after they are placed in the mail, for purposes of determining when the three-business-day waiting period required under § 226.19(a)(2)(ii) begins. Creditors that use electronic mail or a courier other than the postal service may also follow this approach.

4. *Basis for annual percentage rate comparison.* To determine whether a creditor must make corrected disclosures under § 226.22, a creditor compares (a) what the annual percentage rate will be at consummation to (b) the annual percentage rate stated in the most recent disclosures the creditor made to the consumer. For

Copyright © 2009 Association of Corporate Counsel

example, assume consummation for a regular mortgage transaction is scheduled for Thursday, June 11, the early disclosures provided in May stated an annual percentage rate of 7.00%, and corrected disclosures received by the consumer on Friday, June 5 stated an annual percentage rate of 7.15%:

i. On Thursday, June 11, the annual percentage rate will be 7.25%, which exceeds the most recently disclosed annual percentage rate by less than the applicable tolerance. The creditor is not required to make additional corrected disclosures or wait an additional three business days under § 226.19(a)(2).

ii. On Thursday, June 11, the annual percentage rate will be 7.30%, which exceeds the most recently disclosed annual percentage rate by more than the applicable tolerance. The creditor must make corrected disclosures such that the consumer receives them on or before Monday, June 8.

19(a)(3) Consumer's waiver of waiting period before consummation.

1. *Modification or waiver.* A consumer may modify or waive the right to a waiting period required by § 226.19(a)(2) only after the creditor makes the disclosures required by § 226.18. The consumer must have a *bona fide* personal financial emergency that necessitates consummating the credit transaction before the end of the waiting period. Whether these conditions are met is determined by the facts surrounding individual situations. The imminent sale of the consumer's home at foreclosure, where the foreclosure sale will proceed unless loan proceeds are made available to the consumer during the waiting period, is one example of a *bona fide* personal financial emergency. Each consumer who is primarily liable on the legal obligation must sign the written statement for the waiver to be effective.

2. *Examples of waivers within the seven-business-day waiting period.* Assume the early disclosures are delivered to the consumer in person on Monday, June 1, and at that time the consumer executes a waiver of the seven-business-day waiting period (which would end on Tuesday, June 9) so that the loan can be consummated on Friday, June 5:

i. If the annual percentage rate on the early disclosures is inaccurate under § 226.22, the creditor must provide a corrected disclosure to the consumer before consummation, which triggers the three-business-day waiting period in § 226.19(a)(2)(ii). After the consumer receives the corrected disclosure, the consumer must execute a waiver of the three-business-day waiting period in order to consummate the transaction on Friday, June 5.

ii. If a change occurs that does not render the annual percentage rate on the early disclosures inaccurate under § 226.22, the creditor must disclose the changed terms before consummation, consistent with § 226.17(f). Disclosure of the changed terms does not trigger an additional waiting period, and the transaction may be consummated on June 5 without the consumer giving the creditor an additional modification or waiver.

3. *Examples of waivers made after the seven-business-day waiting period.* Assume the early disclosures are delivered to the consumer in person on Monday, June 1 and consummation is scheduled for Friday, June 19. On Wednesday, June 17, a change to the annual percentage rate occurs:

i. If the annual percentage rate on the early disclosures is inaccurate under § 226.22, the creditor must provide a corrected disclosure to the consumer before consummation, which triggers the three-business-day waiting period in § 226.19(a)(2). After the consumer receives the corrected disclosure, the consumer must execute a waiver of the three-business-day waiting period in order to consummate the transaction on Friday, June 19.

ii. If a change occurs that does not render the annual percentage rate on the early disclosures inaccurate under § 226.22, the creditor must disclose the changed terms before consummation, consistent with § 226.17(f). Disclosure of the changed terms does not trigger an additional waiting period, and the transaction may be consummated on Friday, June 19 without the consumer giving the creditor an additional modification or waiver.

19(a)(4) Notice.

1. *Inclusion in other disclosures.* The notice required by § 226.19(a)(4) must be grouped together with the disclosures required by § 226.19(a)(1)(i) or § 226.19(a)(2). *See* comment 17(a)(1)–2 for a discussion of the rules for segregating disclosures. In other cases, the notice set forth in § 226.19(a)(4) may be disclosed together with or separately from the disclosures required under § 226.18. *See* comment 17(a)(1)–5(xvi).

19(a)(5)(ii) Time of disclosures for timeshare plans.

1. *Timing.* A mortgage transaction secured by a consumer's interest in a "timeshare plan," as defined in 11 U.S.C. 101(53D), that is also a Federally related mortgage loan under RESPA is subject to the requirements of § 226.19(a)(5) instead of the requirements of § 226.19(a)(1) through § 226.19(a)(4). *See* comment 19(a)(1)(i)–1. Early disclosures for transactions subject to § 226.19(a)(5) must be given (a) before consummation or (b) within three business days after the creditor receives the consumer's written application, whichever is earlier. The general definition of "business day" in § 226.2(a)(6)—a day on which the creditor's offices are open to the public for substantially all of its business functions—applies for purposes of § 226.19(a)(5)(ii). *See* comment 2(a)(6)–1. These timing requirements are different from the timing requirements under § 226.19(a)(1)(i). Timeshare transactions covered by § 226.19(a)(5) may be consummated any time after the disclosures required by § 226.19(a)(5)(ii) are provided.

2. *Use of estimates.* If the creditor does not know the precise credit terms, the creditor must base the disclosures on the best information reasonably available and indicate that the disclosures are estimates under § 226.17(c)(2). If many of the disclosures are estimates, the creditor may include a statement to that effect (such as "all numerical disclosures except the late-payment disclosure are estimates") instead of separately labelling each estimate. In the alternative, the creditor may label as an estimate only the items primarily affected by unknown information. (*See* the commentary to § 226.17(c)(2).) The creditor may provide explanatory material concerning the estimates and the contingencies that may affect the actual terms, in accordance with the commentary to § 226.17(a)(1).

3. *Written application.* For timeshare transactions, creditors may rely on comment 19(a)(1)(i)–3 in determining whether a "written application" has been received.

4. *Denied or withdrawn applications.* For timeshare transactions, creditors may rely on comment 19(a)(1)(i)–4 in determining that disclosures are not required by § 226.19(a)(5)(ii) because the consumer's application will not or cannot be approved on the terms requested or the consumer has withdrawn the application.

5. *Itemization of amount financed.* For timeshare transactions, creditors may rely on comment 19(a)(1)(i)–5 in determining whether providing the good faith estimates of settlement costs required by RESPA satisfies the requirement of § 226.18(c) to provide an itemization of the amount financed.

19(a)(5)(iii) Redisclosure for timeshare plans.

1. *Consummation or settlement.* For extensions of credit secured by a consumer's timeshare plan, when corrected disclosures are required, they

Copyright © 2009 Association of Corporate Counsel

must be given no later than "consummation or settlement." "Consummation" is defined in § 226.2(a). "Settlement" is defined in Regulation X (24 CFR 3500.2(b)) and is subject to any interpretations issued by HUD. In some cases, a creditor may delay redisclosure until settlement, which may be at a time later than consummation. If a creditor chooses to redisclose at settlement, disclosures may be based on the terms in effect at settlement, rather than at consummation. For example, in a variable-rate transaction, a creditor may choose to base disclosures on the terms in effect at settlement, despite the general rule in comment 17(c)(1)–8 that variable-rate disclosures should be based on the terms in effect at consummation.

2. *Content of new disclosures.* Creditors may rely on comment 19(a)(2)(ii)–2 in determining the content of corrected disclosures required under § 226.19(a)(5)(iii).

■ 9. In Supplement I to Part 226, under *Section 226.31—General Rules,* heading *Paragraph 31(c)(2) Disclosures for reverse mortgages* and paragraph 31(c)(2)–1 are revised, to read as follows:

Subpart E—Special Rules for Certain Home Mortgage Transactions

§ 226.31 General Rules

* * * * *

31(c)(2) Disclosures for reverse mortgages.

1. *Business days.* For purposes of providing reverse mortgage disclosures, "business day" has the same meaning as in comment 31(c)(1)–1—all calendar days except Sundays and the Federal legal holidays listed in 5 U.S.C. 6103(a). This means if disclosures are provided on a Friday, consummation could occur any time on Tuesday, the third business day following receipt of the disclosures.

* * * * *

By order of the Board of Governors of the Federal Reserve System, May 13, 2009.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. E9–11567 Filed 5–18–09; 8:45 am]

BILLING CODE P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2008–1245; Directorate Identifier 2008–NE–27–AD; Amendment 39–15912; AD 2009–11–02]

RIN 2120–AA64

Airworthiness Directives; CFM International S.A. Model CFM56 Turbofan Engines

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule.

SUMMARY: The FAA is adopting a new airworthiness directive (AD) for CFM International S.A. CFM56–2, CFM56–3, CFM56–5A, CFM56–5B, CFM56–5C, and CFM56–7B series turbofan engines with certain part number (P/N) and serial number (SN) high-pressure compressor (HPC) 4–9 spools installed. This AD requires removing certain HPC 4–9 spools listed by P/N and SN in this AD. This AD results from reports of certain HPC 4–9 spools that Propulsion Technology LLC (PTLLC) improperly repaired and returned to service. We are issuing this AD to prevent cracking of the HPC 4–9 spool, which could result in possible uncontained failure of the spool and damage to the airplane.

DATES: This AD becomes effective June 23, 2009.

ADDRESSES: The Docket Operations office is located at Docket Management Facility, U.S. Department of Transportation, 1200 New Jersey Avenue, SE., West Building Ground Floor, Room W12–140, Washington, DC 20590–0001.

FOR FURTHER INFORMATION CONTACT: Stephen K. Sheely, Aerospace Engineer, Engine Certification Office, FAA, Engine & Propeller Directorate, 12 New England Executive Park, Burlington, MA 01803; e-mail: *stephen.k.sheely@faa.gov;* telephone (781) 238–7750; fax (781) 238–7199.

SUPPLEMENTARY INFORMATION: The FAA proposed to amend 14 CFR part 39 with a proposed AD. The proposed AD applies to CFM International S.A. CFM56–2, CFM56–3, CFM56–5A, CFM56–5B, CFM56–5C, and CFM56–7B series turbofan engines with certain P/N and SN HPC 4–9 spools installed. We published the proposed AD in the **Federal Register** on November 26, 2008 (73 FR 71951). That action proposed to require removing certain HPC 4–9 spools that have a P/N and SN listed in Table 1 of this AD before accumulating 8,900 cycles since repair at PTLLC or within 1,100 cycles from the effective date of this AD, whichever occurs later.

Examining the AD Docket

You may examine the AD docket on the Internet at *http://www.regulations.gov;* or in person at the Docket Operations office between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The AD docket contains this AD, the regulatory evaluation, any comments received, and other information. The street address for the Docket Operations office (telephone (800) 647–5527) is provided in the **ADDRESSES** section. Comments will be available in the AD docket shortly after receipt.

Comments

We provided the public the opportunity to participate in the development of this AD. We have considered the comments received.

Incorrect SN in Table 1 of the Proposed AD

Three commenters, the Air Transport Association (ATA), United Airlines, and CFM International, point out a typographical error in the SN for a 4–9 spool, P/N 1590M29G01. They state that the Special Airworthiness Information Bulletin (SAIB) NE–08–17 shows SN GWNFY924 for that P/N and the proposed rule shows SN GWNFY824 for the same P/N.

We agree. Serial number GWNFY924 is the correct SN. We changed Table 1, P/N 1590M29G01 SN "GWNFY824," to "GWNFY924" in this AD.

Request To Clarify the Relationship Between SAIB NE–08–17 and the Proposed AD

One commenter, the ATA, suggests the proposed AD doesn't show a clear relationship between its requirements and those contained in SAIB NE–08–17. The ATA suggests we provide a clarification and a better understanding of why we wrote SAIB NE–08–17 and the proposed rule. The ATA also asks if the recommendations or the hardware listed in SAIB NE–08–17 is still in effect.

We partially agree. The proposed AD specifies the same twenty-six 4–9 spools as SAIB NE–08–17. Special Airworthiness Information Bulletin NE–08–17 still provides recommendations for dispositioning other parts listed in that SAIB. However, we don't require removing the hardware listed in SAIB NE–08–17, other than the 4–9 spools. We didn't change the AD.

Flood Insurance – Essential Steps

1. Security interest in improved real estate? If yes, go to step 2
2. Is transaction to make, increase, extend or renew a loan? If yes, go to step 3
3. Determination if in flood hazard area "A" or "V." May rely on former determination (up to 7 years old) but will lose life-of-loan tracking. If yes, proceed to step 4. If no, file determination with other collateral documentation.
4. Notify borrower of need for flood insurance (notice requires signature). Must get new signature if transaction is to make, increase, extend or renew a loan.
5. Obtain documentation for flood insurance prior to closing (policy or application…no binders!)
6. Complete Flood Insurance Checklist (revised 08/2009)
7. Confirm appropriate insurance at or before loan closing
8. Confirm borrower signature obtained for notice at or before loan closing
9. If 7 and 8 are not satisfied, do NOT close the loan!!!
10. Obtain Team Leader signature on Flood Insurance Checklist
11. Forward Flood Insurance Checklist to Loan Servicing or Compliance

Copyright © 2009 Association of Corporate Counsel

Flood Insurance Checklist

Borrower Name: ______________________________ Property Address: ____________________________	Loan #: ________________
Documentation • Special Flood Hazard Determination Form (SFHDF) • Notice to borrower provided *(Note: must provide new notice even if relying on old SFHDF)* • Borrower signature obtained *(Note: if "No," ensure that signature is obtained at closing)*	Date: ____ / ____ / 20___ Date: ____ / ____ / 20___ Yes _____ No _____
Insurance Amount Analysis	
1. Loan Amount *(Note: for equity loans, include amount of all outstanding liens including un-advanced lines)*	$_______________
2. Maximum Available under NFIP $250,000 residential (1-4, multi-family, mixed-use) $500,000 non-residential Residential Condos - $250,000 (x) number of units ______	$_______________
3. Replacement Cost (appraisal w/ no depreciation or from policy declaration page for condominiums)	$_______________
4. Hazard Insurance Coverage	$_______________
Amount of Flood Insurance Required (Lesser of 1-4) *Note: must have 100% of replacement cost (from policy declaration page) for Condominium RCBAP*	$_______________
Flood Insurance Policy	
Flood Insurance Coverage	$_______________
Sufficient? (*Note: must be at least the lesser of 1-5 above*)	Yes _____ No _____
Proof of insurance (declaration, endorsement, application, certificate, etc.) (*Note: cannot be a binder)*	_________________
SFHDF and insurance policy show same Flood Zone?	Yes _____ No _____
Policy expiration date	Date: ____ / ____ / 20___
Deductible *(Note: please refer to loan policy for limits. Example, Residential Lending limits deductible to the greater of $1,000 or 1% of policy coverage)*	$_______________

Revised 08/2009

Team Leader signature: ______________________________ Date: ________________

Form reviewed by: Compliance ________ /Loan Servicing: ________ Date: ________________

Copyright © 2009 Association of Corporate Counsel

Commercial Lending
HMDA Loan/Application Register FAQ
(Revised January 2009)

General Reporting

What loans are HMDA reportable?
Any loans used to purchase or improve residential real estate (whether or not a security interest is taken on that residential real estate) must be reported. In addition, any loans to refinance existing debt secured by residential real estate must be reported.

What type of property is considered residential real estate?
Any property that contains housing units, including single-family dwellings, condominiums, multi-family housing, apartment buildings, etc. regardless of whether or not it is owner-occupied or investment property. If a mixed-use building, the property is residential if more than 50% of the income derived is from the residential units.

What do I do with the form once completed?
Forward a copy of the form to Carolyn Hardy (W1B-1) and include copy in loan documentation for Loan Servicing.

[B] Application Number

What should we use for an application number?
Use the loan number for originated loans. For "applications" that do not result in an originated loan, the HMDA data administrator from the mortgage department will assign one.

[C] Application Date

What date should we use for an application date if we do not have a written application?
Use the date we receive the financial statements of the business or personal financial statements from the applicant.

[F] Loan Purpose

What does "improve" mean?
Any portion of the funds used for repairs, additions, modifications, etc. would be considered improvements, even if a small minority of the loan proceeds were used for that purpose.

What if there are multiple purposes?
The order of priority would be purchase, improvement, then refinance. If the purpose of the loan proceeds were to acquire a residential property and to make modifications to the property, it would be reported as a purchase (1).

What is considered a "refinance"?
A refinance is a loan secured by a dwelling that replaces (i.e. pays off) a loan secured by a dwelling (such as debt-consolidation, including the replacement of a home loan or home line-of-credit).

[G] Occupancy

What code should I use for occupancy?
Use 1 only for owner-occupied dwellings. Use code 2 for non-owner occupied 1-4 family dwellings. Use code 3 for multifamily dwellings.

[I] Pre-approval

What loans are subject to pre-approval?
Bank does not have any pre-approval programs that meet the definition for reporting purposes. Report "3" for "Not applicable."

Copyright © 2009 Association of Corporate Counsel

[J] Action Taken

What applications are we to report?
All applications that are HMDA reportable (see General Reporting FAQ above) must be reported, not just those that we originate. This would include those applications that result in denials, offers to lend in which applicants obtain a loan elsewhere, or withdrawn applications.

- Use code 1 for loans that originate.
- Use code 2 for those loans that were approved by credit committee, but did not result in a closed loan.
- Use code 3 for requests for credit that were denied.
- Use code 4 for those requests that were expressly withdrawn by the applicant prior to a credit decision being made.
- Use code 5 for those requests that could not be acted upon because the applicant did not provide additional information needed to make a decision on the application.

[K] Action Date

What date do we report?
Use the date on which the loan closes (note date). For applications that do not result in a closed loan, use the following dates:

- For applications reported as action taken code 2 (approved but not accepted), use the date on which the commitment expires.
- For applications reported as action taken code 3 (denied), use the date on which the credit decision was made.
- For applications reported as action taken code 4 (withdrawn), use the date on which the applicant contacted the lender to withdraw interest in the credit.
- For applications reported as action taken code 5 (incomplete), use the due date of the information requested.

[L] Property Location

What address should we use?
In general, use the address of the residential property involved in the transaction. The Mortgage Department will generate the proper codes for reporting purposes. Please make sure the address you list on the data-entry form is correct.

[M][N][O] Applicant Ethnicity, Race and Sex

What should we report for applicant ethnicity, race and sex?
Only collect this information if the borrowing entity is a natural person. In most (if not all) cases, the borrowing entities in the commercial lending area will be entities that are not natural persons. In that case, report the codes for the applicant as "Not applicable" for Ethnicity ("4"), Race ("7") and Sex ("4") and for the co-applicant as "No co-applicant" for Ethnicity ("5"), Race ("8") and Sex ("5").

[P] Income

What should we report for income?
Only report this data if personal income was used to underwrite the loan, and report as an annual number (in thousands). However, most (if not all) loans involve business income or property cash flow, in which case "NA" should be reported.

[Q] Purchaser

What should we report for Purchaser?
Report "0" for no purchaser, as these are primarily used to track secondary market mortgage transactions.

[R] Reasons for Denial

What should we report for denial reasons?
This is optional reporting. Bank does not report this data. Leave it blank.

Copyright © 2009 Association of Corporate Counsel

[T] HOEPA Status

What do we report for HOEPA status?
HOEPA only applies to loans for personal, family, or household use. In general this should not apply to business loans. Report "2" for "Not a HOEPA loan."

[U] Lien Status

What do we report for lien status?
Report the proper code based on our lien position on the residential property, "1" for 1st liens, "2" for all other junior liens, and "3" is no lien was taken on the residential property (but the purpose still meets the general reporting requirements). Code 4 will not be used, as this applies only to loans purchased by the bank.

Copyright © 2009 Association of Corporate Counsel

HMDA Loan/Application Register
Data Entry form
(Enter information in the space provided or circle selection)

Is the loan to PURCHASE, REFINANCE, or IMPROVE residential real estate?
If yes, continue below. If no, do not complete this form.

[A] Application Name:	______________________									
[B] Application Number:	______________________									
[C] Application Date:	____/____/20___ Month Day Year									
[D] Loan Type:	1	2	3	4						
[E] Property Type:	1	2	3							
[F] Loan Purpose:	1	2	3							
[G] Owner Occupancy:	1	2	3							
[H] Loan Amount in Thousands:	__________									
[I] Pre-approval	1	2	3							
[J] Action Taken	1	2	3	4	5	6	7	8		
[K] Action Taken Date	____/____/20___ Month Day Year									
[L] Property Location	______________________ Number, Street, City, State, Zip									
[M] Applicant Ethnicity	1	2	3	4	5					
[M] Co-applicant Ethnicity	1	2	3	4	5					
[N] Applicant Race	1	2	3	4	5	6	7	8		
[N] Co-applicant Race	1	2	3	4	5	6	7	8		
[O] Applicant Sex	1	2	3	4	5					
[O] Co-applicant Sex	1	2	3	4	5					
[P] Gross Annual Income	NA	_______ (report amount in thousands if personal income used)								
[Q] Type of Purchaser	1	2	3	4	5	6	7	8	9	0
[R] Reasons for Denial (Optional, check all that apply)	1	2	3	4	5	6	7	8	9	
[S] Rate Spread	NA									
[T] HOEPA Status	1	2								
[U] Lien Status	1	2	3	4						

Completed by: ______________________ **Date:** ________________

Copyright © 2009 Association of Corporate Counsel

HMDA Loan/Application Register

Application or Loan Information

[D] Loan Type:
1 – Conventional (any loan other than VA, FSA, or RHS)
2 – FHA-insured (Federal Housing Administration)
3 – VA-guaranteed (Veterans Administration)
4 – FSA/RHA (Farm Service Agency or Rural Housing Service)

[E] Property Type:
1 – One to four family (other than manufactured housing)
2 – Manufactured housing
3 – Multi-family

[F] Purpose of Loan:
1 – Home purchase
2 – Home improvement
3 – Refinance

[G] Owner Occupancy:
1 – Owner-occupied
2 – Non-owner occupied
3 – Not applicable

[I] Pre-approval (home purchase only):
1 – Pre-approval requested
2 – Pre-approval not requested
3 – Not applicable

[J] Action Taken:
1 – Loan originated
2 – Application approved but not accepted
3 – Application denied
4 – Application withdrawn by applicant
5 – File closed for incompleteness

Action Taken (continued):
6 – Loan purchased by financial institution
7 – Pre-approval request denied by financial institution
8 – Pre-approval request approved by not accepted (optional)

Applicant Information

[M] Ethnicity:
1 – Hispanic or Latino
2 – Not Hispanic or Latino
3 – Information not provided by applicant in mail, Internet, or telephone application
4 – Not applicable
5 – No co-applicant

[N] Race:
1 – American Indian or Alaska Native
2 – Asian
3 – Black or African American
4 – Native Hawaiian or Other Pacific Islander
5 – White
6 – Information not provided by applicant in mail, Internet, or telephone application
7 – Not applicable
8 – No co-applicant

[O] Sex:
1 – Male
2 – Female
3 – Information not provided by applicant in mail, Internet, or telephone application
4 – Not applicable
5 – No co-applicant

[Q] Type of Purchaser:
0 – Loan was not originated or was not sold in calendar year
1 – Fannie Mae

Type or Purchaser (continued):
2 – Ginnie Mae
3 – Freddie Mac
4 – Farmer Mac
5 – Private securitization
6 – Commercial bank, savings bank or savings association
7 – Life insurance company, credit union, mortgage bank, or finance company
8 – Affiliate institution
9 – Other type of purchaser

Reasons for Denial (optional) [R]

1 – Debt to income ratio
2 – Employment history
3 – Credit history
4 – Collateral
5 – Insufficient cash (downpayment, closing costs)
6 – Unverifiable information
7 – Credit application incomplete
8 – Mortgage insurance denied
9 – Other

Other Data

[T] HOEPA Status (only for loans originated or purchased):
1 – HOEPA loan
2 – Not a HOEPA loan

[U] Lien Status (only for applications and originations):
1 – Secured by a first lien
2 – Secured by a subordinate lien
3 – Not secured by a lien
4 – Not applicable (purchased loans)

Copyright © 2009 Association of Corporate Counsel

Unlawful Internet Gambling Enforcement Act of 2006 – 31 USC 5361 et seq.

Regulation GG

Copyright © 2009 Association of Corporate Counsel

Office of the Law Revision Counsel, U.S. House of Representatives
Home Search Download Classification Codification Popular Names About

Go to 1st query term(s)

-CITE-

31 USC Sec. ***5361*** 01/08/2008

-EXPCITE-

TITLE 31 - MONEY AND FINANCE

SUBTITLE IV - MONEY

CHAPTER 53 - MONETARY TRANSACTIONS

SUBCHAPTER IV - PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING

-HEAD-

Sec. 5361. Congressional findings and purpose

-STATUTE-

(a) Findings. - Congress finds the following:

(1) Internet gambling is primarily funded through personal use of payment system instruments, credit cards, and wire transfers.

(2) The National Gambling Impact Study Commission in 1999 recommended the passage of legislation to prohibit wire transfers to Internet gambling sites or the banks which represent such sites.

(3) Internet gambling is a growing cause of debt collection problems for insured depository institutions and the consumer credit industry.

(4) New mechanisms for enforcing gambling laws on the Internet are necessary because traditional law enforcement mechanisms are often inadequate for enforcing gambling prohibitions or regulations on the Internet, especially where such gambling crosses State or national borders.

(b) Rule of Construction. - No provision of this subchapter shall

Copyright © 2009 Association of Corporate Counsel

be construed as altering, limiting, or extending any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States.

-SOURCE-

(Added Pub. L. 109-347, title VIII, Sec. 802(a), Oct. 13, 2006, 120 Stat. 1952.)

-MISC1-

INTERNET GAMBLING IN OR THROUGH FOREIGN JURISDICTIONS

Pub. L. 109-347, title VIII, Sec. 803, Oct. 13, 2006, 120 Stat. 1962, provided that:

"(a) In General. - In deliberations between the United States Government and any foreign country on money laundering, corruption, and crime issues, the United States Government should -

"(1) encourage cooperation by foreign governments and relevant international fora in identifying whether Internet gambling operations are being used for money laundering, corruption, or other crimes;

"(2) advance policies that promote the cooperation of foreign governments, through information sharing or other measures, in the enforcement of this Act [probably means title VIII of Pub. L. 109-347, which enacted this subchapter, see Short Title of 2006 Amendment note set out under section 5301 of this title]; and

"(3) encourage the Financial Action Task Force on Money Laundering, in its annual report on money laundering typologies, to study the extent to which Internet gambling operations are being used for money laundering purposes.

"(b) Report Required. - The Secretary of the Treasury shall submit an annual report to the Congress on any deliberations between the United States and other countries on issues relating to

Copyright © 2009 Association of Corporate Counsel

Internet gambling."

Copyright © 2009 Association of Corporate Counsel

Office of the Law Revision Counsel, U.S. House of Representatives

Home Search Download Classification Codification Popular Names About

Go to 1st query term(s)

-CITE-

31 USC Sec. 5362 01/08/2008

-EXPCITE-

TITLE 31 - MONEY AND FINANCE

SUBTITLE IV - MONEY

CHAPTER 53 - MONETARY TRANSACTIONS

SUBCHAPTER IV - PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING

-HEAD-

Sec. 5362. Definitions

-STATUTE-

In this subchapter:

(1) Bet or wager. - The term "bet or wager" -

(**A**) means the staking or risking by any person of something of value upon the outcome of ***a*** contest of others, ***a*** sporting event, or ***a*** game subject to chance, upon an agreement or understanding that the person or another person will receive something of value in the event of ***a*** certain outcome;

(B) includes the purchase of ***a*** chance or opportunity to win ***a*** lottery or other prize (which opportunity to win is predominantly subject to chance);

(C) includes any scheme of ***a*** type described in section 3702 of title 28;

(D) includes any instructions or information pertaining to the establishment or movement of funds by the bettor or customer in, to, or from an account with the business of betting or wagering; and

Copyright © 2009 Association of Corporate Counsel

(E) does not include -

(i) any activity governed by the securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (!1) for the purchase or sale of securities (as that term is defined in section 3(a)(10) of that Act);

(ii) any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act;

(iii) any over-the-counter derivative instrument;

(iv) any other transaction that -

(I) is excluded or exempt from regulation under the Commodity Exchange Act; or

(II) is exempt from State gaming or bucket shop laws under section 12(e) of the Commodity Exchange Act or section 28(a) of the Securities Exchange Act of 1934;

(v) any contract of indemnity or guarantee;

(vi) any contract for insurance;

(vii) any deposit or other transaction with an insured depository institution;

(viii) participation in any game or contest in which participants do not stake or risk anything of value other than -

(I) personal efforts of the participants in playing the game or contest or obtaining access to the Internet; or

(II) points or credits that the sponsor of the game or contest provides to participants free of charge and that can be used or redeemed only for participation in games or contests offered by the sponsor; or

Copyright © 2009 Association of Corporate Counsel

(ix) participation in any fantasy or simulation sports game or educational game or contest in which (if the game or contest involves a team or teams) no fantasy or simulation sports team is based on the current membership of an actual team that is a member of an amateur or professional sports organization (as those terms are defined in section 3701 of title 28) and that meets the following conditions:

(I) All prizes and awards offered to winning participants are established and made known to the participants in advance of the game or contest and their value is not determined by the number of participants or the amount of any fees paid by those participants.

(II) All winning outcomes reflect the relative knowledge and skill of the participants and are determined predominantly by accumulated statistical results of the performance of individuals (athletes in the case of sports events) in multiple real-world sporting or other events.

(III) No winning outcome is based -

(aa) on the score, point-spread, or any performance or performances of any single real-world team or any combination of such teams; or

(bb) solely on any single performance of an individual athlete in any single real-world sporting or other event.

(2) Business of betting or wagering. - The term "business of betting or wagering" does not include the activities of a financial transaction provider, or any interactive computer service or telecommunications service.

(3) Designated payment system. - The term "designated payment system" means any system utilized by a financial transaction provider that the Secretary and the Board of Governors of the

Copyright © 2009 Association of Corporate Counsel

Federal Reserve System, in consultation with the Attorney General, jointly determine, by regulation or order, could be utilized in connection with, or to facilitate, any restricted transaction.

(4) Financial transaction provider. - The term "financial transaction provider" means **a** creditor, credit card issuer, financial institution, operator of **a** terminal at which an electronic fund transfer may be initiated, money transmitting business, or international, national, regional, or local payment network utilized to effect **a** credit transaction, electronic fund transfer, stored value product transaction, or money transmitting service, or **a** participant in such network, or other participant in **a** designated payment system.

(5) Internet. - The term "Internet" means the international computer network of interoperable packet switched data networks.

(6) Interactive computer service. - The term "interactive computer service" has the meaning given the term in section 230(f) of the Communications Act of 1934 (47 U.S.C. 230(f)).

(7) Restricted transaction. - The term "restricted transaction" means any transaction or transmittal involving any credit, funds, instrument, or proceeds described in any paragraph of section 5363 which the recipient is prohibited from accepting under section 5363.

(8) Secretary. - The term "Secretary" means the Secretary of the Treasury.

(9) State. - The term "State" means any State of the United States, the District of Columbia, or any commonwealth, territory, or other possession of the United States.

(10) Unlawful internet gambling. -

(**A**) In general. - The term "unlawful Internet gambling" means

Copyright © 2009 Association of Corporate Counsel

to place, receive, or otherwise knowingly transmit a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made.

(B) Intrastate transactions. - The term "unlawful Internet gambling" does not include placing, receiving, or otherwise transmitting a bet or wager where -

(i) the bet or wager is initiated and received or otherwise made exclusively within a single State;

(ii) the bet or wager and the method by which the bet or wager is initiated and received or otherwise made is expressly authorized by and placed in accordance with the laws of such State, and the State law or regulations include -

(I) age and location verification requirements reasonably designed to block access to minors and persons located out of such State; and

(II) appropriate data security standards to prevent unauthorized access by any person whose age and current location has not been verified in accordance with such State's law or regulations; and

(iii) the bet or wager does not violate any provision of -

(I) the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.);

(II) chapter 178 of title 28 (commonly known as the "Professional and Amateur Sports Protection Act");

(III) the Gambling Devices Transportation Act (15 U.S.C. 1171 et seq.); or

(IV) the Indian Gaming Regulatory Act (25 U.S.C. 2701 et

Copyright © 2009 Association of Corporate Counsel

seq.).

(C) Intratribal transactions. - The term "unlawful Internet gambling" does not include placing, receiving, or otherwise transmitting a bet or wager where -

(i) the bet or wager is initiated and received or otherwise made exclusively -

(I) within the Indian lands of a single Indian tribe (as such terms are defined under the Indian Gaming Regulatory Act); or

(II) between the Indian lands of 2 or more Indian tribes to the extent that intertribal gaming is authorized by the Indian Gaming Regulatory Act;

(ii) the bet or wager and the method by which the bet or wager is initiated and received or otherwise made is expressly authorized by and complies with the requirements of -

(I) the applicable tribal ordinance or resolution approved by the Chairman of the National Indian Gaming Commission; and

(II) with respect to class III gaming, the applicable Tribal-State Compact;

(iii) the applicable tribal ordinance or resolution or Tribal-State Compact includes -

(I) age and location verification requirements reasonably designed to block access to minors and persons located out of the applicable Tribal lands; and

(II) appropriate data security standards to prevent unauthorized access by any person whose age and current location has not been verified in accordance with the applicable tribal ordinance or resolution or Tribal-State

Copyright © 2009 Association of Corporate Counsel

Compact; and

(iv) the bet or wager does not violate any provision of -

(I) the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.);

(II) chapter 178 of title 28 (commonly known as the "Professional and Amateur Sports Protection Act");

(III) the Gambling Devices Transportation Act (15 U.S.C. 1171 et seq.); or

(IV) the Indian Gaming Regulatory Act (25 U.S.C. 2701 et seq.).

(D) Interstate horseracing. -

(i) In general. - The term "unlawful Internet gambling" shall not include any activity that is allowed under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.).

(ii) Rule of construction regarding preemption. - Nothing in this subchapter may be construed to preempt any State law prohibiting gambling.

(iii) Sense of congress. - It is the sense of Congress that this subchapter shall not change which activities related to horse racing may or may not be allowed under Federal law. This subparagraph is intended to address concerns that this subchapter could have the effect of changing the existing relationship between the Interstate Horseracing Act and other Federal statutes in effect on the date of the enactment of this subchapter. This subchapter is not intended to change that relationship. This subchapter is not intended to resolve any existing disagreements over how to interpret the relationship between the Interstate Horseracing Act and other Federal statutes.

(E) Intermediate routing. - The intermediate routing of

Copyright © 2009 Association of Corporate Counsel

electronic data shall not determine the location or locations in which a bet or wager is initiated, received, or otherwise made.

(11) Other terms. -

(A) Credit; creditor; credit card; and card issuer. - The terms "credit", "creditor", "credit card", and "card issuer" have the meanings given the terms in section 103 of the Truth in Lending Act (15 U.S.C. 1602).

(B) Electronic fund transfer. - The term "electronic fund transfer" -

(i) has the meaning given the term in section 903 of the Electronic Fund Transfer Act (15 U.S.C. 1693a), except that the term includes transfers that would otherwise be excluded under section 903(6)(E) of that Act; and

(ii) includes any fund transfer covered by Article 4A of the Uniform Commercial Code, as in effect in any State.

(C) Financial institution. - The term "financial institution" has the meaning given the term in section 903 of the Electronic Fund Transfer Act, except that such term does not include a casino, sports book, or other business at or through which bets or wagers may be placed or received.

(D) Insured depository institution. - The term "insured depository institution" -

(i) has the meaning given the term in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)); and

(ii) includes an insured credit union (as defined in section 101 of the Federal Credit Union Act).

(E) Money transmitting business and money transmitting service. - The terms "money transmitting business" and "money transmitting service" have the meanings given the terms in

Copyright © 2009 Association of Corporate Counsel

section 5330(d) (determined without regard to any regulations prescribed by the Secretary thereunder).

-SOURCE-

(Added Pub. L. 109-347, title VIII, Sec. 802(**a**), Oct. 13, 2006, 120 Stat. 1953.)

-REFTEXT-

REFERENCES IN TEXT

Sections 3(**a**)(47) and 28(**a**) of the Securities Exchange Act of 1934, referred to in par. (1)(E)(i), (iv)(II), are classified to sections 78c(**a**)(47) and 78bb(**a**), respectively, of Title 15, Commerce and Trade.

The Commodity Exchange Act, referred to in par. (1)(E)(ii), (iv)(II), is act Sept. 21, 1922, ch. 369, 42 Stat. 998, which is classified generally to chapter 1 (Sec. 1 et seq.) of Title 7, Agriculture. Section 12(e) of the Act is classified to section 16(e) of Title 7. For complete classification of this Act to the Code, see section 1 of Title 7 and Tables.

The Interstate Horseracing Act of 1978, referred to in par. (10)(B)(iii)(I), (C)(iv)(I), (D)(i), (iii), is Pub. L. 95-515, Oct. 25, 1978, 92 Stat. 1811, which is classified generally to chapter 57 (Sec. 3001 et seq.) of Title 15, Commerce and Trade. For complete classification of this Act to the Code, see Short Title note set out under section 3001 of Title 15 and Tables.

The Gambling Devices Transportation Act, referred to in par. (10)(B)(iii)(III), (C)(iv)(III), is act Jan. 2, 1951, ch. 1194, 64 Stat. 1134, which is classified generally to chapter 24 (Sec. 1171 et seq.) of Title 15, Commerce and Trade. For complete classification of this Act to the Code, see Short Title note set out under section 1171 of Title 15 and Tables.

The Indian Gaming Regulatory Act, referred to in par.

Copyright © 2009 Association of Corporate Counsel

(10)(B)(iii)(IV), (C)(i), (iv)(IV), is Pub. L. 100-497, Oct. 17, 1988, 102 Stat. 2467, which is classified principally to chapter 29 (Sec. 2701 et seq.) of Title 25, Indians. For complete classification of this Act to the Code, see Short Title note set out under section 2701 of Title 25 and Tables.

The date of the enactment of this subchapter, referred to in par. (10)(D)(iii), is the date of enactment of Pub. L. 109-347, which was approved Oct. 13, 2006.

Section 101 of the Federal Credit Union Act, referred to in par. (11)(D)(ii), is classified to section 1752 of Title 12, Banks and Banking.

-FOOTNOTE-

(!1) So in original. Probably should be followed by a closing parenthesis.

Office of the Law Revision Counsel, U.S. House of Representatives

Copyright © 2009 Association of Corporate Counsel

Office of the Law Revision Counsel, U.S. House of Representatives

Go to 1st query term(s)

-CITE-

31 USC Sec. 5363 01/08/2008

-EXPCITE-

TITLE 31 - MONEY AND FINANCE

SUBTITLE IV - MONEY

CHAPTER 53 - MONETARY TRANSACTIONS

SUBCHAPTER IV - PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING

-HEAD-

Sec. 5363. Prohibition on acceptance of any financial instrument for unlawful Internet gambling

-STATUTE-

No person engaged in the business of betting or wagering may knowingly accept, in connection with the participation of another person in unlawful Internet gambling -

(1) credit, or the proceeds of credit, extended to or on behalf of such other person (including credit extended through the use of ***a*** credit card);

(2) an electronic fund transfer, or funds transmitted by or through ***a*** money transmitting business, or the proceeds of an electronic fund transfer or money transmitting service, from or on behalf of such other person;

(3) any check, draft, or similar instrument which is drawn by or on behalf of such other person and is drawn on or payable at or through any financial institution; or

(4) the proceeds of any other form of financial transaction, as the Secretary and the Board of Governors of the Federal Reserve

Copyright © 2009 Association of Corporate Counsel

System may jointly prescribe by regulation, which involves **a** financial institution as **a** payor or financial intermediary on behalf of or for the benefit of such other person.

-SOURCE-

(Added Pub. L. 109-347, title VIII, Sec. 802(**a**), Oct. 13, 2006, 120 Stat. 1957.)

Office of the Law Revision Counsel, U.S. House of Representatives

Copyright © 2009 Association of Corporate Counsel

Office of the Law Revision Counsel, U.S. House of Representatives

Home Search Download Classification Codification Popular Names About

Go to 1st query term(s)

-CITE-

31 USC Sec. 5364 01/08/2008

-EXPCITE-

TITLE 31 - MONEY AND FINANCE

SUBTITLE IV - MONEY

CHAPTER 53 - MONETARY TRANSACTIONS

SUBCHAPTER IV - PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING

-HEAD-

Sec. 5364. Policies and procedures to identify and prevent restricted transactions

-STATUTE-

(**a**) Regulations. - Before the end of the 270-day period beginning on the date of the enactment of this subchapter, the Secretary and the Board of Governors of the Federal Reserve System, in consultation with the Attorney General, shall prescribe regulations (which the Secretary and the Board jointly determine to be appropriate) requiring each designated payment system, and all participants therein, to identify and block or otherwise prevent or prohibit restricted transactions through the establishment of policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit the acceptance of restricted transactions in any of the following ways:

(1) The establishment of policies and procedures that -

(**A**) allow the payment system and any person involved in the payment system to identify restricted transactions by means of codes in authorization messages or by other means; and

Copyright © 2009 Association of Corporate Counsel

(B) block restricted transactions identified as **a** result of the policies and procedures developed pursuant to subparagraph (**A**).

(2) The establishment of policies and procedures that prevent or prohibit the acceptance of the products or services of the payment system in connection with **a** restricted transaction.

(b) Requirements for Policies and Procedures. - In prescribing regulations under subsection (**a**), the Secretary and the Board of Governors of the Federal Reserve System shall -

(1) identify types of policies and procedures, including nonexclusive examples, which would be deemed, as applicable, to be reasonably designed to identify and block or otherwise prevent or prohibit the acceptance of the products or services with respect to each type of restricted transaction;

(2) to the extent practical, permit any participant in **a** payment system to choose among alternative means of identifying and blocking, or otherwise preventing or prohibiting the acceptance of the products or services of the payment system or participant in connection with, restricted transactions;

(3) exempt certain restricted transactions or designated payment systems from any requirement imposed under such regulations, if the Secretary and the Board jointly find that it is not reasonably practical to identify and block, or otherwise prevent or prohibit the acceptance of, such transactions; and

(4) ensure that transactions in connection with any activity excluded from the definition of unlawful internet gambling in subparagraph (B), (C), or (D)(i) of section 5362(10) are not blocked or otherwise prevented or prohibited by the prescribed regulations.

Copyright © 2009 Association of Corporate Counsel

(c) Compliance With Payment System Policies and Procedures. - A financial transaction provider shall be considered to be in compliance with the regulations prescribed under subsection (a) if -

(1) such person relies on and complies with the policies and procedures of a designated payment system of which it is a member or participant to -

(A) identify and block restricted transactions; or

(B) otherwise prevent or prohibit the acceptance of the products or services of the payment system, member, or participant in connection with restricted transactions; and

(2) such policies and procedures of the designated payment system comply with the requirements of regulations prescribed under subsection (a).

(d) No Liability for Blocking or Refusing To Honor Restricted Transactions. - A person that identifies and blocks a transaction, prevents or prohibits the acceptance of its products or services in connection with a transaction, or otherwise refuses to honor a transaction -

(1) that is a restricted transaction;

(2) that such person reasonably believes to be a restricted transaction; or

(3) as a designated payment system or a member of a designated payment system in reliance on the policies and procedures of the payment system, in an effort to comply with regulations prescribed under subsection (a),

shall not be liable to any party for such action.

(e) Regulatory Enforcement. - The requirements under this section shall be enforced exclusively by -

(1) the Federal functional regulators, with respect to the designated payment systems and financial transaction providers

Copyright © 2009 Association of Corporate Counsel

subject to the respective jurisdiction of such regulators under section 505(**a**) of the Gramm-Leach-Bliley Act and section 5g of the Commodities Exchange Act; and

(2) the Federal Trade Commission, with respect to designated payment systems and financial transaction providers not otherwise subject to the jurisdiction of any Federal functional regulators (including the Commission) as described in paragraph (1).

-SOURCE-

(Added Pub. L. 109-347, title VIII, Sec. 802(**a**), Oct. 13, 2006, 120 Stat. 1958.)

-REFTEXT-

REFERENCES IN TEXT

The date of the enactment of this subchapter, referred to in subsec. (**a**), is the date of enactment of Pub. L. 109-347, which was approved Oct. 13, 2006.

Section 505(**a**) of the Gramm-Leach-Bliley Act, referred to in subsec. (e)(1), is classified to section 6805(**a**) of Title 15, Commerce and Trade.

Section 5g of the Commodities Exchange Act, referred to in subsec. (e)(1), is classified to section 7b-2 of Title 7, Agriculture.

Copyright © 2009 Association of Corporate Counsel

-CITE-

31 USC Sec. 5365 01/08/2008

-EXPCITE-

TITLE 31 - MONEY AND FINANCE

SUBTITLE IV - MONEY

CHAPTER 53 - MONETARY TRANSACTIONS

SUBCHAPTER IV - PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING

-HEAD-

Sec. 5365. Civil remedies

-STATUTE-

(**a**) Jurisdiction. - In addition to any other remedy under current law, the district courts of the United States shall have original and exclusive jurisdiction to prevent and restrain restricted transactions by issuing appropriate orders in accordance with this section, regardless of whether **a** prosecution has been initiated under this subchapter.

(b) Proceedings. -

(1) Institution by federal government. -

(**A**) In general. - The United States, acting through the Attorney General, may institute proceedings under this section to prevent or restrain **a** restricted transaction.

(B) Relief. - Upon application of the United States under this paragraph, the district court may enter **a** temporary restraining order, **a** preliminary injunction, or an injunction against any person to prevent or restrain **a** restricted transaction, in accordance with rule 65 of the Federal Rules of

Copyright © 2009 Association of Corporate Counsel

Civil Procedure.

(2) Institution by state attorney general. -

(A) In general. - The attorney general (or other appropriate State official) of a State in which a restricted transaction allegedly has been or will be initiated, received, or otherwise made may institute proceedings under this section to prevent or restrain the violation or threatened violation.

(B) Relief. - Upon application of the attorney general (or other appropriate State official) of an affected State under this paragraph, the district court may enter a temporary restraining order, a preliminary injunction, or an injunction against any person to prevent or restrain a restricted transaction, in accordance with rule 65 of the Federal Rules of Civil Procedure.

(3) Indian lands. -

(A) In general. - Notwithstanding paragraphs (1) and (2), for a restricted transaction that allegedly has been or will be initiated, received, or otherwise made on Indian lands (as that term is defined in section 4 of the Indian Gaming Regulatory Act) -

(i) the United States shall have the enforcement authority provided under paragraph (1); and

(ii) the enforcement authorities specified in an applicable Tribal-State Compact negotiated under section 11 of the Indian Gaming Regulatory Act (25 U.S.C. 2710) shall be carried out in accordance with that compact.

(B) Rule of construction. - No provision of this section shall be construed as altering, superseding, or otherwise affecting the application of the Indian Gaming Regulatory Act.

Copyright © 2009 Association of Corporate Counsel

(c) Limitation Relating to Interactive Computer Services. -

(1) In general. - Relief granted under this section against an interactive computer service shall -

(A) be limited to the removal of, or disabling of access to, an online site violating section 5363, or a hypertext link to an online site violating such section, that resides on a computer server that such service controls or operates, except that the limitation in this subparagraph shall not apply if the service is subject to liability under this section under section 5367;

(B) be available only after notice to the interactive computer service and an opportunity for the service to appear are provided;

(C) not impose any obligation on an interactive computer service to monitor its service or to affirmatively seek facts indicating activity violating this subchapter;

(D) specify the interactive computer service to which it applies; and

(E) specifically identify the location of the online site or hypertext link to be removed or access to which is to be disabled.

(2) Coordination with other law. - An interactive computer service that does not violate this subchapter shall not be liable under section 1084(d) of title 18, except that the limitation in this paragraph shall not apply if an interactive computer service has actual knowledge and control of bets and wagers and -

(A) operates, manages, supervises, or directs an Internet website at which unlawful bets or wagers may be placed, received, or otherwise made or at which unlawful bets or wagers are offered to be placed, received, or otherwise made; or

Copyright © 2009 Association of Corporate Counsel

(B) owns or controls, or is owned or controlled by, any person who operates, manages, supervises, or directs an Internet website at which unlawful bets or wagers may be placed, received, or otherwise made, or at which unlawful bets or wagers are offered to be placed, received, or otherwise made.

(d) Limitation on Injunctions Against Regulated Persons. - Notwithstanding any other provision of this section, and subject to section 5367, no provision of this subchapter shall be construed as authorizing the Attorney General of the United States, or the attorney general (or other appropriate State official) of any State to institute proceedings to prevent or restrain **a** restricted transaction against any financial transaction provider, to the extent that the person is acting as **a** financial transaction provider.

-SOURCE-

(Added Pub. L. 109-347, title VIII, Sec. 802(**a**), Oct. 13, 2006, 120 Stat. 1959.)

-REFTEXT-

REFERENCES IN TEXT

Rule 65 of the Federal Rules of Civil Procedure, referred to in subsec. (b)(1)(B), (2)(B), is set out in the Appendix to Title 28, Judiciary and Judicial Procedure.

The Indian Gaming Regulatory Act, referred to in subsec. (b)(3), is Pub. L. 100-497, Oct. 17, 1988, 102 Stat. 2467, which is classified principally to chapter 29 (Sec. 2701 et seq.) of Title 25, Indians. Section 4 of the Act is classsified to section 2703 of Title 25. For complete classification of this Act to the Code, see Short Title note set out under section 2701 of Title 25 and Tables.

Copyright © 2009 Association of Corporate Counsel

Go to 1st query term(s)

-CITE-

31 USC Sec. 5366 01/08/2008

-EXPCITE-

TITLE 31 - MONEY AND FINANCE

SUBTITLE IV - MONEY

CHAPTER 53 - MONETARY TRANSACTIONS

SUBCHAPTER IV - PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING

-HEAD-

Sec. 5366. Criminal penalties

-STATUTE-

(**a**) In General. - Any person who violates section 5363 shall be fined under title 18, imprisoned for not more than 5 years, or both.

(b) Permanent Injunction. - Upon conviction of **a** person under this section, the court may enter **a** permanent injunction enjoining such person from placing, receiving, or otherwise making bets or wagers or sending, receiving, or inviting information assisting in the placing of bets or wagers.

-SOURCE-

(Added Pub. L. 109-347, title VIII, Sec. 802(**a**), Oct. 13, 2006, 120 Stat. 1961.)

Copyright © 2009 Association of Corporate Counsel

Office of the Law Revision Counsel, U.S. House of Representatives
Home Search Download Classification Codification Popular Names About

Go to 1st query term(s)

-CITE-

31 USC Sec. 5367 01/08/2008

-EXPCITE-

TITLE 31 - MONEY AND FINANCE

SUBTITLE IV - MONEY

CHAPTER 53 - MONETARY TRANSACTIONS

SUBCHAPTER IV - PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING

-HEAD-

Sec. 5367. Circumventions prohibited

-STATUTE-

Notwithstanding section 5362(2), **a** financial transaction provider, or any interactive computer service or telecommunications service, may be liable under this subchapter if such person has actual knowledge and control of bets and wagers, and -

(1) operates, manages, supervises, or directs an Internet website at which unlawful bets or wagers may be placed, received, or otherwise made, or at which unlawful bets or wagers are offered to be placed, received, or otherwise made; or

(2) owns or controls, or is owned or controlled by, any person who operates, manages, supervises, or directs an Internet website at which unlawful bets or wagers may be placed, received, or otherwise made, or at which unlawful bets or wagers are offered to be placed, received, or otherwise made.

-SOURCE-

(Added Pub. L. 109-347, title VIII, Sec. 802(**a**), Oct. 13, 2006, 120 Stat. 1961.)

Copyright © 2009 Association of Corporate Counsel

Electronic Code of Federal Regulations
e-CFR™

e-CFR Data is current as of August 14, 2009

Title 12: Banks and Banking

Browse Previous | Browse Next

PART 233—PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING (REGULATION GG)

Section Contents

§ 233.1 Authority, purpose, collection of information, and incorporation by reference.
§ 233.2 Definitions.
§ 233.3 Designated payment systems.
§ 233.4 Exemptions.
§ 233.5 Policies and procedures required.
§ 233.6 Non-exclusive examples of policies and procedures.
§ 233.7 Regulatory enforcement.
Appendix A to Part 233—Model Notice

Authority: 31 U.S.C. 5364.

Source: Reg. GG, 73 FR 69405, Nov. 18, 2008, unless otherwise noted.

§ 233.1 Authority, purpose, collection of information, and incorporation by reference.

top

(a) *Authority.* This part is issued jointly by the Board of Governors of the Federal Reserve System (Board) and the Secretary of the Department of the Treasury (Treasury) under section 802 of the Unlawful Internet Gambling Enforcement Act of 2006 (Act) (enacted as Title VIII of the Security and Accountability For Every Port Act of 2006, Pub. L. No. 109–347, 120 Stat. 1884, and codified at 31 U.S.C. 5361–5367). The Act states that none of its provisions shall be construed as altering, limiting, or extending any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States. *See* 31 U.S.C. 5361(b). In addition, the Act states that its provisions are not intended to change which activities related to horseracing may or may not be allowed under Federal law, are not intended to change the existing relationship between the Interstate Horseracing Act of 1978 (IHA) (15 U.S.C. 3001 *et seq.*) and other Federal statutes in effect on October 13, 2006, the date of the Act's enactment, and are not intended to resolve any existing disagreements over how to interpret the relationship between the IHA and other Federal statutes. *See* 31 U.S.C. 5362(10)(D)(iii). This part is intended to be consistent with these provisions.

(b) *Purpose.* The purpose of this part is to issue implementing regulations as required by the Act. The part sets out necessary definitions, designates payment systems subject to the requirements of this part, exempts certain participants in designated payment systems from certain requirements of this part,

Copyright © 2009 Association of Corporate Counsel

provides nonexclusive examples of policies and procedures reasonably designed to identify and block, or otherwise prevent and prohibit, restricted transactions, and sets out the Federal entities that have exclusive regulatory enforcement authority with respect to the designated payments systems and non-exempt participants therein.

(c) *Collection of information.* The Office of Management and Budget (OMB) has approved the collection of information requirements in this part for the Department of the Treasury and assigned OMB control number 1505–0204. The Board has approved the collection of information requirements in this part under the authority delegated to the Board by OMB, and assigned OMB control number 7100–0317.

(d) *Incorporation by reference—relevant definitions from ACH rules.* (1) This part incorporates by reference the relevant definitions of ACH terms as published in the "2008 ACH Rules: A Complete Guide to Rules & Regulations Governing the ACH Network" (the "ACH Rules"). The Director of the Federal Register approves this incorporation by reference in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies of the "2008 ACH Rules" are available from the National Automated Clearing House Association, Suite 100, 13450 Sunrise Valley Drive, Herndon, Virginia 20171, *http://nacha.org* , (703) 561–1100. Copies also are available for public inspection at the Department of Treasury Library, Room 1428, Main Treasury Building, 1500 Pennsylvania Avenue, NW., Washington, DC 20220, and the National Archives and Records Administration (NARA). Before visiting the Treasury library, you must call (202) 622–0990 for an appointment. For information on the availability of this material at NARA, call (202) 741–6030, or go to: *http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html 20002.*

(2) Any amendment to definitions of the relevant ACH terms in the ACH Rules shall not apply to this part unless the Treasury and the Board jointly accept such amendment by publishing notice of acceptance of the amendment to this part in theFederal Register.An amendment to the definition of a relevant ACH term in the ACH Rules that is accepted by the Treasury and the Board shall apply to this part on the effective date of the rulemaking specified by the Treasury and the Board in the jointFederal Registernotice expressly accepting such amendment.

§ 233.2 Definitions.

top

The following definitions apply solely for purposes of this part:

(a) *Actual knowledge* with respect to a transaction or commercial customer means when a particular fact with respect to that transaction or commercial customer is known by or brought to the attention of:

(1) An individual in the organization responsible for the organization's compliance function with respect to that transaction or commercial customer; or

(2) An officer of the organization.

(b) *Automated clearing house system* or *ACH system* means a funds transfer system, primarily governed by the ACH Rules, which provides for the clearing and settlement of batched electronic entries for participating financial institutions. When referring to ACH systems, the terms in this regulation (such as "originating depository financial institution," "operator," "originating gateway operator," "receiving depository financial institution," "receiving gateway operator," and "third-party sender") are defined as those terms are defined in the ACH Rules.

(c) *Bet or wager:*

(1) Means the staking or risking by any person of something of value upon the outcome of a contest of others, a sporting event, or a game subject to chance, upon an agreement or understanding that the person or another person will receive something of value in the event of a certain outcome;

(2) Includes the purchase of a chance or opportunity to win a lottery or other prize (which opportunity to win is predominantly subject to chance);

Copyright © 2009 Association of Corporate Counsel

(3) Includes any scheme of a type described in 28 U.S.C. 3702;

(4) Includes any instructions or information pertaining to the establishment or movement of funds by the bettor or customer in, to, or from an account with the business of betting or wagering (which does not include the activities of a financial transaction provider, or any interactive computer service or telecommunications service); and

(5) Does not include—

(i) Any activity governed by the securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) for the purchase or sale of securities (as that term is defined in section 3(a)(10) of that act (15 U.S.C. 78c(a)(10));

(ii) Any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*);

(iii) Any over-the-counter derivative instrument;

(iv) Any other transaction that—

(A) Is excluded or exempt from regulation under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*); or

(B) Is exempt from State gaming or bucket shop laws under section 12(e) of the Commodity Exchange Act (7 U.S.C. 16(e)) or section 28(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78bb(a));

(v) Any contract of indemnity or guarantee;

(vi) Any contract for insurance;

(vii) Any deposit or other transaction with an insured depository institution;

(viii) Participation in any game or contest in which participants do not stake or risk anything of value other than—

(A) Personal efforts of the participants in playing the game or contest or obtaining access to the Internet; or

(B) Points or credits that the sponsor of the game or contest provides to participants free of charge and that can be used or redeemed only for participation in games or contests offered by the sponsor; or

(ix) Participation in any fantasy or simulation sports game or educational game or contest in which (if the game or contest involves a team or teams) no fantasy or simulation sports team is based on the current membership of an actual team that is a member of an amateur or professional sports organization (as those terms are defined in 28 U.S.C. 3701) and that meets the following conditions:

(A) All prizes and awards offered to winning participants are established and made known to the participants in advance of the game or contest and their value is not determined by the number of participants or the amount of any fees paid by those participants.

(B) All winning outcomes reflect the relative knowledge and skill of the participants and are determined predominantly by accumulated statistical results of the performance of individuals (athletes in the case of sports events) in multiple real-world sporting or other events.

(C) No winning outcome is based—

(*1*) On the score, point-spread, or any performance or performances of any single real-world team or any combination of such teams, or

Copyright © 2009 Association of Corporate Counsel

(2) Solely on any single performance of an individual athlete in any single real-world sporting or other event.

(d) *Block* means to reject a particular transaction before or during processing, but it does not require freezing or otherwise prohibiting subsequent transfers or transactions regarding the proceeds or account.

(e) *Card issuer* means any person who issues a credit card, debit card, pre-paid card, or stored value card, or the agent of such person with respect to such card.

(f) *Card system* means a system for authorizing, clearing and settling transactions in which credit cards, debit cards, pre-paid cards, or stored value cards (such cards being issued or authorized by the operator of the system), are used to purchase goods or services or to obtain a cash advance. The term includes systems both in which the merchant acquirer, card issuer, and system operator are separate entities and in which more than one of these roles are performed by the same entity.

(g) *Check clearing house* means an association of banks or other payors that regularly exchange checks for collection or return.

(h) *Check collection system* means an interbank system for collecting, presenting, returning, and settling for checks or intrabank system for settling for checks deposited in and drawn on the same bank. When referring to check collection systems, the terms in this regulation (such as "paying bank," "collecting bank," "depositary bank," "returning bank," and "check") are defined as those terms are defined in 12 CFR 229.2. For purposes of this part, "check" also includes an electronic representation of a check that a bank agrees to handle as a check.

(i) *Commercial customer* means a person that is not a consumer and that contracts with a non-exempt participant in a designated payment system to receive, or otherwise accesses, payment transaction services through that non-exempt participant.

(j) *Consumer* means a natural person.

(k) *Designated payment system* means a system listed in §__.3.

(l) *Electronic fund transfer* has the same meaning given the term in section 903 of the Electronic Fund Transfer Act (15 U.S.C. 1693a), except that such term includes transfers that would otherwise be excluded under section 903(6)(E) of that act (15 U.S.C. 1693a(6)(E)), and includes any funds transfer covered by Article 4A of the Uniform Commercial Code, as in effect in any State.

(m) *Financial institutio* n means a State or national bank, a State or Federal savings and loan association, a mutual savings bank, a State or Federal credit union, or any other person that, directly or indirectly, holds an account belonging to a consumer. The term does not include a casino, sports book, or other business at or through which bets or wagers may be placed or received.

(n) *Financial transaction provider* means a creditor, credit card issuer, financial institution, operator of a terminal at which an electronic fund transfer may be initiated, money transmitting business, or international, national, regional, or local payment network utilized to effect a credit transaction, electronic fund transfer, stored value product transaction, or money transmitting service, or a participant in such network, or other participant in a designated payment system.

(o) *Foreign banking office* means:

(1) Any non-U.S. office of a financial institution; and

(2) Any non-U.S. office of a foreign bank as described in 12 U.S.C. 3101(7).

(p) *Interactive computer service* means any information service, system, or access software provider that provides or enables computer access by multiple users to a computer server, including specifically a service or system that provides access to the Internet and such systems operated or services offered by libraries or educational institutions.

Copyright © 2009 Association of Corporate Counsel

(q) *Internet* means the international computer network of interoperable packet switched data networks.

(r) *Internet gambling business* means the business of placing, receiving or otherwise knowingly transmitting a bet or wager by any means which involves the use, at least in part, of the Internet, but does not include the performance of the customary activities of a financial transaction provider, or any interactive computer service or telecommunications service.

(s) *Intrastate transaction* means placing, receiving, or otherwise transmitting a bet or wager where—

(1) The bet or wager is initiated and received or otherwise made exclusively within a single State;

(2) The bet or wager and the method by which the bet or wager is initiated and received or otherwise made is expressly authorized by and placed in accordance with the laws of such State, and the State law or regulations include—

(i) Age and location verification requirements reasonably designed to block access to minors and persons located out of such State; and

(ii) Appropriate data security standards to prevent unauthorized access by any person whose age and current location has not been verified in accordance with such State's law or regulations; and

(3) The bet or wager does not violate any provision of—

(i) The Interstate Horseracing Act of 1978 (15 U.S.C. 3001 *et seq.*);

(ii) 28 U.S.C. chapter 178 (professional and amateur sports protection);

(iii) The Gambling Devices Transportation Act (15 U.S.C. 1171 *et seq.*); or

(iv) The Indian Gaming Regulatory Act (25 U.S.C. 2701 *et seq.*).

(t) *Intratribal transaction* means placing, receiving or otherwise transmitting a bet or wager where—

(1) The bet or wager is initiated and received or otherwise made exclusively—

(i) Within the Indian lands of a single Indian tribe (as such terms are defined under the Indian Gaming Regulatory Act (25 U.S.C. 2703)); or

(ii) Between the Indian lands of two or more Indian tribes to the extent that intertribal gaming is authorized by the Indian Gaming Regulatory Act (25 U.S.C. 2701 *et seq.*);

(2) The bet or wager and the method by which the bet or wager is initiated and received or otherwise made is expressly authorized by and complies with the requirements of—

(i) The applicable tribal ordinance or resolution approved by the Chairman of the National Indian Gaming Commission; and

(ii) With respect to class III gaming, the applicable Tribal-State compact;

(3) The applicable tribal ordinance or resolution or Tribal-State compact includes—

(i) Age and location verification requirements reasonably designed to block access to minors and persons located out of the applicable Tribal lands; and

(ii) Appropriate data security standards to prevent unauthorized access by any person whose age and current location has not been verified in accordance with the applicable tribal ordinance or resolution or Tribal-State Compact; and

Copyright © 2009 Association of Corporate Counsel

(4) The bet or wager does not violate any provision of—

(i) The Interstate Horseracing Act of 1978 (15 U.S.C. 3001 *et seq.*);

(ii) 28 U.S.C. chapter 178 (professional and amateur sports protection);

(iii) The Gambling Devices Transportation Act (15 U.S.C. 1171 *et seq.*); or

(iv) The Indian Gaming Regulatory Act (25 U.S.C. 2701 *et seq.*).

(u) *Money transmitting business* has the meaning given the term in 31 U.S.C. 5330(d)(1) (determined without regard to any regulations prescribed by the Secretary of the Treasury thereunder).

(v) *Operator* of a designated payment system means an entity that provides centralized clearing and delivery services between participants in the designated payment system and maintains the operational framework for the system. In the case of an automated clearinghouse system, the term "operator" has the same meaning as provided in the ACH Rules.

(w) *Participant in a designated payment system* means an operator of a designated payment system, a financial transaction provider that is a member of, or has contracted for financial transaction services with, or is otherwise participating in, a designated payment system, or a third-party processor. This term does not include a customer of the financial transaction provider, unless the customer is also a financial transaction provider otherwise participating in the designated payment system on its own behalf.

(x) *Reasoned legal opinion* means a written expression of professional judgment by a State-licensed attorney that addresses the facts of a particular client's business and the legality of the client's provision of its services to relevant customers in the relevant jurisdictions under applicable federal and State law, and, in the case of intratribal transactions, applicable tribal ordinances, tribal resolutions, and Tribal-State compacts. A written legal opinion will not be considered "reasoned" if it does nothing more than recite the facts and express a conclusion.

(y) *Restricted transaction* means any of the following transactions or transmittals involving any credit, funds, instrument, or proceeds that the Act prohibits any person engaged in the business of betting or wagering (which does not include the activities of a financial transaction provider, or any interactive computer service or telecommunications service) from knowingly accepting, in connection with the participation of another person in unlawful Internet gambling—

(1) Credit, or the proceeds of credit, extended to or on behalf of such other person (including credit extended through the use of a credit card);

(2) An electronic fund transfer, or funds transmitted by or through a money transmitting business, or the proceeds of an electronic fund transfer or money transmitting service, from or on behalf of such other person; or

(3) Any check, draft, or similar instrument that is drawn by or on behalf of such other person and is drawn on or payable at or through any financial institution.

(z) *State* means any State of the United States, the District of Columbia, or any commonwealth, territory, or other possession of the United States, including the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, and the Virgin Islands.

(aa) *Third-party processor* means a service provider that—

(1) In the case of a debit transaction payment, such as an ACH debit entry or card system transaction, has a direct relationship with the commercial customer that is initiating the debit transfer transaction and acts as an intermediary between the commercial customer and the first depository institution to handle the transaction;

(2) In the case of a credit transaction payment, such as an ACH credit entry, has a direct relationship with the commercial customer that is to receive the proceeds of the credit transfer and acts as an

Copyright © 2009 Association of Corporate Counsel

intermediary between the commercial customer and the last depository institution to handle the transaction; and

(3) In the case of a cross-border ACH debit or check collection transaction, is the first service provider located within the United States to receive the ACH debit instructions or check for collection.

(bb) *Unlawful Internet gambling* means to place, receive, or otherwise knowingly transmit a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made. The term does not include placing, receiving, or otherwise transmitting a bet or wager that is excluded from the definition of this term by the Act as an intrastate transaction or an intra-tribal transaction, and does not include any activity that is allowed under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 *et seq.* ; *see* §233.1(a)). The intermediate routing of electronic data shall not determine the location or locations in which a bet or wager is initiated, received, or otherwise made.

(cc) *Wire transfer system* means a system through which an unconditional order to a bank to pay a fixed or determinable amount of money to a beneficiary upon receipt, or on a day stated in the order, is transmitted by electronic or other means through the network, between banks, or on the books of a bank. When referring to wire transfer systems, the terms in this regulation (such as "bank," "originator's bank," "beneficiary's bank," and "intermediary bank") are defined as those terms are defined in 12 CFR part 210, appendix B.

§ 233.3 Designated payment systems.

top

The following payment systems could be used by participants in connection with, or to facilitate, a restricted transaction:

(a) Automated clearing house systems;

(b) Card systems;

(c) Check collection systems;

(d) Money transmitting businesses solely to the extent they

(1) Engage in the transmission of funds, which does not include check cashing, currency exchange, or the issuance or redemption of money orders, travelers' checks, and other similar instruments; and

(2) Permit customers to initiate transmission of funds transactions remotely from a location other than a physical office of the money transmitting business; and

(e) Wire transfer systems.

§ 233.4 Exemptions.

top

(a) *Automated clearing house systems.* The participants processing a particular transaction through an automated clearing house system are exempt from this regulation's requirements for establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions with respect to that transaction, except for—

(1) The receiving depository financial institution and any third-party processor receiving the transaction on behalf of the receiver in an ACH credit transaction;

Copyright © 2009 Association of Corporate Counsel

(2) The originating depository financial institution and any third-party processor initiating the transaction on behalf of the originator in an ACH debit transaction; and

(3) The receiving gateway operator and any third-party processor that receives instructions for an ACH debit transaction directly from a foreign sender (which could include a foreign banking office, a foreign third-party processor, or a foreign originating gateway operator).

(b) *Check collection systems.* The participants in a particular check collection through a check collection system are exempt from this regulation's requirements for establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions with respect to that check collection, except for the depositary bank.

(c) *Money transmitting businesses.* The participants in a money transmitting business are exempt from this regulation's requirements for establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions, except for the operator.

(d) *Wire transfer systems.* The participants in a particular wire transfer through a wire transfer system are exempt from this regulation's requirements for establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions with respect to that transaction, except for the beneficiary's bank.

§ 233.5 Policies and procedures required.

top

(a) All non-exempt participants in designated payment systems shall establish and implement written policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions.

(b) A non-exempt financial transaction provider participant in a designated payment system shall be considered to be in compliance with the requirements of paragraph (a) of this section if—

(1) It relies on and complies with the written policies and procedures of the designated payment system that are reasonably designed to—

(i) Identify and block restricted transactions; or

(ii) Otherwise prevent or prohibit the acceptance of the products or services of the designated payment system or participant in connection with restricted transactions; and

(2) Such policies and procedures of the designated payment system comply with the requirements of this part.

(c) For purposes of paragraph (b)(2) in this section, a participant in a designated payment system may rely on a written statement or notice by the operator of that designated payment system to its participants that states that the operator has designed or structured the system's policies and procedures for identifying and blocking or otherwise preventing or prohibiting restricted transactions to comply with the requirements of this part as conclusive evidence that the system's policies and procedures comply with the requirements of this part, unless the participant is notified otherwise by its Federal functional regulator or, in the case of participants that are not directly supervised by a Federal functional regulator, the Federal Trade Commission.

(d) As provided in the Act, a person that identifies and blocks a transaction, prevents or prohibits the acceptance of its products or services in connection with a transaction, or otherwise refuses to honor a transaction, shall not be liable to any party for such action if—

(1) The transaction is a restricted transaction;

(2) Such person reasonably believes the transaction to be a restricted transaction; or

Copyright © 2009 Association of Corporate Counsel

(3) The person is a participant in a designated payment system and blocks or otherwise prevents the transaction in reliance on the policies and procedures of the designated payment system in an effort to comply with this regulation.

(e) Nothing in this part requires or is intended to suggest that designated payment systems or participants therein must or should block or otherwise prevent or prohibit any transaction in connection with any activity that is excluded from the definition of "unlawful Internet gambling" in the Act as an intrastate transaction, an intratribal transaction, or a transaction in connection with any activity that is allowed under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 *et seq.* ; see §233.1(a)).

(f) Nothing in this part modifies any requirement imposed on a participant by other applicable law or regulation to file a suspicious activity report to the appropriate authorities.

(g) The requirement of this part to establish and implement written policies and procedures applies only to the U.S. offices of participants in designated payment systems.

§ 233.6 Non-exclusive examples of policies and procedures.

top

(a) *In general.* The examples of policies and procedures to identify and block or otherwise prevent or prohibit restricted transactions set out in this section are non-exclusive. In establishing and implementing written policies and procedures to identify and block or otherwise prevent or prohibit restricted transactions, a non-exempt participant in a designated payment system is permitted to design and implement policies and procedures tailored to its business that may be different than the examples provided in this section. In addition, non-exempt participants may use different policies and procedures with respect to different business lines or different parts of the organization.

(b) *Due diligence.* If a non-exempt participant in a designated payment system establishes and implements procedures for due diligence of its commercial customer accounts or commercial customer relationships in order to comply, in whole or in part, with the requirements of this regulation, those due diligence procedures will be deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions if the procedures include the steps set out in paragraphs (b)(1), (b)(2), and (b)(3) of this section and subject to paragraph (b)(4) of this section.

(1) At the establishment of the account or relationship, the participant conducts due diligence of a commercial customer and its activities commensurate with the participant's judgment of the risk of restricted transactions presented by the customer's business.

(2) Based on its due diligence, the participant makes a determination regarding the risk the commercial customer presents of engaging in an Internet gambling business and follows either paragraph (b)(2)(i) or (b)(2)(ii) of this section.

(i) The participant determines that the commercial customer presents a minimal risk of engaging in an Internet gambling business.

(ii) The participant cannot determine that the commercial customer presents a minimal risk of engaging in an Internet gambling business, in which case it obtains the documentation in either paragraph (b)(2)(ii)(A) or (b)(2)(ii)(B) of this section—

(A) Certification from the commercial customer that it does not engage in an Internet gambling business; or

(B) If the commercial customer does engage in an Internet gambling business, each of the following—

(*1*) Evidence of legal authority to engage in the Internet gambling business, such as—

(*i*) A copy of the commercial customer's license that expressly authorizes the customer to engage in the Internet gambling business issued by the appropriate State or Tribal authority or, if the commercial

Copyright © 2009 Association of Corporate Counsel

customer does not have such a license, a reasoned legal opinion that demonstrates that the commercial customer's Internet gambling business does not involve restricted transactions; and

(*ii*) A written commitment by the commercial customer to notify the participant of any changes in its legal authority to engage in its Internet gambling business.

(2) A third-party certification that the commercial customer's systems for engaging in the Internet gambling business are reasonably designed to ensure that the commercial customer's Internet gambling business will remain within the licensed or otherwise lawful limits, including with respect to age and location verification.

(3) The participant notifies all of its commercial customers, through provisions in the account or commercial customer relationship agreement or otherwise, that restricted transactions are prohibited from being processed through the account or relationship.

(4) With respect to the determination in paragraph (b)(2)(i) of this section, participants may deem the following commercial customers to present a minimal risk of engaging in an Internet gambling business—

(i) An entity that is directly supervised by a Federal functional regulator as set out in §233.7(a); or

(ii) An agency, department, or division of the Federal government or a State government.

(c) *Automated clearing house system examples.* (1) The policies and procedures of the originating depository financial institution and any third party processor in an ACH debit transaction, and the receiving depository financial institution and any third party processor in an ACH credit transaction, are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions if they—

(i) Address methods to conduct due diligence in establishing a commercial customer account or relationship as set out in §233.6(b);

(ii) Address methods to conduct due diligence as set out in §233.6(b)(2)(ii)(B) in the event that the participant has actual knowledge that an existing commercial customer of the participant engages in an Internet gambling business; and

(iii) Include procedures to be followed with respect to a commercial customer if the originating depository financial institution or third-party processor has actual knowledge that its commercial customer has originated restricted transactions as ACH debit transactions or if the receiving depository financial institution or third-party processor has actual knowledge that its commercial customer has received restricted transactions as ACH credit transactions, such as procedures that address—

(A) The circumstances under which the commercial customer should not be allowed to originate ACH debit transactions or receive ACH credit transactions; and

(B) The circumstances under which the account should be closed.

(2) The policies and procedures of a receiving gateway operator and third-party processor that receives instructions to originate an ACH debit transaction directly from a foreign sender are deemed to be reasonably designed to prevent or prohibit restricted transactions if they include procedures to be followed with respect to a foreign sender if the receiving gateway operator or third-party processor has actual knowledge, obtained through notification by a government entity, such as law enforcement or a regulatory agency, that such instructions included instructions for restricted transactions. Such procedures may address sending notification to the foreign sender, such as in the form of the notice contained in appendix A to this part.

(d) *Card system examples.* The policies and procedures of a card system operator, a merchant acquirer, third-party processor, or a card issuer, are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions, if the policies and procedures—

Copyright © 2009 Association of Corporate Counsel

(1) Provide for either—

(i) Methods to conduct due diligence—

(A) In establishing a commercial customer account or relationship as set out in §233.6(b); and

(B) As set out in §233.6(b)(2)(ii)(B) in the event that the participant has actual knowledge that an existing commercial customer of the participant engages in an Internet gambling business; or

(ii) Implementation of a code system, such as transaction codes and merchant/business category codes, that are required to accompany the authorization request for a transaction, including—

(A) The operational functionality to enable the card system operator or the card issuer to reasonably identify and deny authorization for a transaction that the coding procedure indicates may be a restricted transaction; and

(B) Procedures for ongoing monitoring or testing by the card system operator to detect potential restricted transactions, including—

(*1*) Conducting testing to ascertain whether transaction authorization requests are coded correctly; and

(*2*) Monitoring and analyzing payment patterns to detect suspicious payment volumes from a merchant customer; and

(2) For the card system operator, merchant acquirer, or third-party processor, include procedures to be followed when the participant has actual knowledge that a merchant has received restricted transactions through the card system, such as—

(i) The circumstances under which the access to the card system for the merchant, merchant acquirer, or third-party processor should be denied; and

(ii) The circumstances under which the merchant account should be closed.

(e) *Check collection system examples.* (1) The policies and procedures of a depositary bank are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions, if they—

(i) Address methods for the depositary bank to conduct due diligence in establishing a commercial customer account or relationship as set out in §233.6(b);

(ii) Address methods for the depositary bank to conduct due diligence as set out in §233.6(b)(2)(ii)(B) in the event that the depositary bank has actual knowledge that an existing commercial customer engages in an Internet gambling business; and

(iii) Include procedures to be followed if the depositary bank has actual knowledge that a commercial customer of the depositary bank has deposited checks that are restricted transactions, such as procedures that address—

(A) The circumstances under which check collection services for the customer should be denied; and

(B) The circumstances under which the account should be closed.

(2) The policies and procedures of a depositary bank that receives checks for collection from a foreign banking office are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions if they include procedures to be followed by the depositary bank when it has actual knowledge, obtained through notification by a government entity, such as law enforcement or a regulatory agency, that a foreign banking office has sent checks to the depositary bank that are restricted transactions. Such procedures may address sending notification to the foreign banking office, such as in the form of the notice contained in the appendix to this part.

Copyright © 2009 Association of Corporate Counsel

(f) *Money transmitting business examples.* The policies and procedures of an operator of a money transmitting business are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions if they—

(1) Address methods for the operator to conduct due diligence in establishing a commercial customer relationship as set out in §233.6(b);

(2) Address methods for the operator to conduct due diligence as set out in §233.6(b)(2)(ii)(B) in the event that the operator has actual knowledge that an existing commercial customer engages in an Internet gambling business;

(3) Include procedures regarding ongoing monitoring or testing by the operator to detect potential restricted transactions, such as monitoring and analyzing payment patterns to detect suspicious payment volumes to any recipient; and

(4) Include procedures when the operator has actual knowledge that a commercial customer of the operator has received restricted transactions through the money transmitting business, that address—

(i) The circumstances under which money transmitting services should be denied to that commercial customer; and

(ii) The circumstances under which the commercial customer account should be closed.

(g) *Wire transfer system examples.* The policies and procedures of the beneficiary's bank in a wire transfer are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions if they—

(1) Address methods for the beneficiary's bank to conduct due diligence in establishing a commercial customer account as set out in §233.6(b);

(2) Address methods for the beneficiary's bank to conduct due diligence as set out in §233.6(b)(2)(ii)(B) in the event that the beneficiary's bank has actual knowledge that an existing commercial customer of the bank engages in an Internet gambling business;

(3) Include procedures to be followed if the beneficiary's bank obtains actual knowledge that a commercial customer of the bank has received restricted transactions through the wire transfer system, such as procedures that address

(i) The circumstances under which the beneficiary bank should deny wire transfer services to the commercial customer; and

(ii) The circumstances under which the commercial customer account should be closed.

§ 233.7 Regulatory enforcement.

top

The requirements under this part are subject to the exclusive regulatory enforcement of—

(a) The Federal functional regulators, with respect to the designated payment systems and participants therein that are subject to the respective jurisdiction of such regulators under section 505(a) of the Gramm-Leach-Bliley Act (15 U.S.C. 6805(a)) and section 5g of the Commodity Exchange Act (7 U.S.C. 7b–2); and

(b) The Federal Trade Commission, with respect to designated payment systems and participants therein not otherwise subject to the jurisdiction of any Federal functional regulators (including the Commission) as described in paragraph (a) of this section.

Copyright © 2009 Association of Corporate Counsel

Appendix A to Part 233—Model Notice

top

[Date]

[Name of foreign sender or foreign banking office]

[Address]

Re: *U.S. Unlawful Internet Gambling Enforcement Act Notice*

Dear [Name of foreign counterparty]:

On [date], U.S. government officials informed us that your institution processed payments through our facilities for Internet gambling transactions restricted by U.S. law on [dates, recipients, and other relevant information if available].

We provide this notice to comply with U.S. Government regulations implementing the Unlawful Internet Gambling Enforcement Act of 2006 (Act), a U.S. federal law. Our policies and procedures established in accordance with those regulations provide that we will notify a foreign counterparty if we learn that the counterparty has processed payments through our facilities for Internet gambling transactions restricted by the Act. This notice ensures that you are aware that we have received information that your institution has processed payments for Internet gambling restricted by the Act.

The Act is codified in subchapter IV, chapter 53, title 31 of the U.S. Code (31 U.S.C. 5361 *et seq.*). Implementing regulations that duplicate one another can be found at part 233 of title 12 of the U.S. Code of Federal Regulations (12 CFR part 233) and part 132 of title 31 of the U.S. Code of Federal Regulations (31 CFR part 132).

Browse Previous | Browse Next

For questions or comments regarding e-CFR editorial content, features, or design, email ecfr@nara.gov.

For questions concerning e-CFR programming and delivery issues, email webteam@gpo.gov.

Section 508 / Accessibility

Copyright © 2009 Association of Corporate Counsel

Federal Register

Tuesday,
July 21, 2009

Part II

Department of the Treasury
Office of the Comptroller of the Currency
Federal Reserve System
Federal Deposit Insurance Corporation
Department of the Treasury
Office of Thrift Supervision
Farm Credit Administration
National Credit Union Administration

Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance; Notice

Copyright © 2009 Association of Corporate Counsel

35914 Federal Register / Vol. 74, No. 138 / Tuesday, July 21, 2009 / Notices

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

[Docket ID OCC 2009–0014]

FEDERAL RESERVE SYSTEM

[Docket No. R–1311]

FEDERAL DEPOSIT INSURANCE CORPORATION

RIN 3064–ZA00

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

[Docket ID OTS–2009–0005]

FARM CREDIT ADMINISTRATION

RIN 3052–AC46

NATIONAL CREDIT UNION ADMINISTRATION

RIN 3133–AD41

Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance

AGENCIES: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision, Treasury (OTS); Farm Credit Administration (FCA); National Credit Union Administration (NCUA).

ACTION: Notice and request for comment.

SUMMARY: The OCC, Board, FDIC, OTS, FCA, and NCUA (collectively, the Agencies) are issuing final revisions to the Interagency Questions and Answers Regarding Flood Insurance (Interagency Questions and Answers). The Agencies are also soliciting comments on proposed revisions to the Interagency Questions and Answers. To help financial institutions meet their responsibilities under Federal flood insurance legislation and to increase public understanding of the flood insurance regulation, the Agencies are finalizing new and revised guidance, as well as proposing new and revised guidance that address the most frequently asked questions about flood insurance. The revised Interagency Questions and Answers contain staff guidance for agency personnel, financial institutions, and the public.

DATES: *Effective date:* September 21, 2009. *Comment due date:* Comments on the proposed questions and answers must be submitted on or before September 21, 2009.

ADDRESSES: *OCC:* Because paper mail in the Washington, DC area and at the Agencies is subject to delay, commenters are encouraged to submit comments by e-mail, if possible. Please use the title ''Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance'' to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- *E-mail: regs.comments@occ.treas.gov.*
- *Mail:* Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 2–3, Washington, DC 20219.
- *Fax:* (202) 874–5274.
- *Hand Delivery/Courier:* 250 E Street, SW., Attn: Communications Division, Mail Stop 2–3, Washington, DC 20219.

Instructions: You must include ''OCC'' as the agency name and ''Docket Number OCC–2009–0014'' in your comment. In general, OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this notice by any of the following methods:

- *Viewing Comments Personally:* You may personally inspect and photocopy comments at the OCC's Communications Division, 250 E Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling in advance (202) 874–4700. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.
- *Docket:* You may also view or request available background documents and project summaries using the methods described above.

Board: You may submit comments, identified by Docket No. R–1311, by any of the following methods:

- *Agency Web Site: http://www.federalreserve.gov.* Follow the instructions for submitting comments at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.*
- *Federal eRulemaking Portal: http://www.Regulation.gov.* Follow the instructions for submitting comments.
- *E-mail: regs.comments@federalreserve.gov.* Include docket number in the subject line of the message.
- *Fax:* (202) 452–3819 or (202) 452–3102.
- *Mail:* Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board's Web site at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm* as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information.

Public comments may also be viewed electronically or in paper in Room MP–500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit comments, identified by RIN number 3064–ZA00 by any of the following methods:

- *Agency Web Site: http://www.fdic.gov/Regulation/laws/federal/propose.html.* Follow instructions for submitting comments on the ''Agency Web Site.''
- *E-mail: Comments@FDIC.gov.* Include the RIN number in the subject line of the message.
- *Mail:* Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.
- *Hand Delivery/Courier:* Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Instructions: All submissions received must include the agency name and RIN number. All comments received will be posted without change to *http://www.fdic.gov/Regulation/laws/federal/propose.html* including any personal information provided.

OTS: You may submit comments, identified by OTS–2009–0005, by any of the following methods:

- *E-mail: regs.comments@ots.treas.gov.* Please include ID OTS–2009–0005 in the subject line of the message and include your name and telephone number in the message.
- *Fax:* (202) 906–6518.
- *Mail:* Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: OTS–2009–0005.
- *Hand Delivery/Courier:* Guard's Desk, East Lobby Entrance, 1700 G

Copyright © 2009 Association of Corporate Counsel

Federal Register / Vol. 74, No. 138 / Tuesday, July 21, 2009 / Notices 35915

Street, NW., from 9 a.m. to 4 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Attention: OTS–2009–0005.

Instructions: All submissions received must include the agency name and docket number for this rulemaking. All comments received will be posted without change, including any personal information provided. Comments, including attachments and other supporting materials received are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

Viewing Comments Electronically: OTS will post comments on the OTS Internet Site at *http://www.ots.treas.gov/?p=opencomment1.*

Viewing Comments On-Site: You may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906–5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906–6518. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

FCA: We offer a variety of methods for you to submit comments. For accuracy and efficiency reasons, we encourage commenters to submit comments by e-mail or through the Agency's Web site or the Federal eRulemaking Portal. You may also send comments by mail or by facsimile transmission. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- *E-mail:* Send us an e-mail at *regcomm@fca.gov.*
- *Agency Web Site: http://www.fca.gov.* Once you are at the Web site, select ''Legal Info,'' then ''Pending Regulation and Notices.''
- *Federal eRulemaking Portal: http://www.Regulation.gov.* Follow the instructions for submitting comments.
- *Mail:* Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102–5090.
- *Fax:* (703) 883–4477. Posting and processing of faxes may be delayed. Please consider another means to comment, if possible.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at *http://www.fca.gov.* Once you are in the Web site, select ''Legal Info,'' and then select ''Public Comments.'' We will show your comments as submitted, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

NCUA: You may submit comments by any of the following methods (Please send comments by one method only):

- *Federal eRulemaking Portal: http://www.Regulation.gov.* Follow the instructions for submitting comments.
- *NCUA Web Site: http://www.ncua.gov/RegulationOpinionsLaws/proposed_regs/proposed_regs.html.* Follow the instructions for submitting comments.
- *E-mail:* Address to *regcomments@ncua.gov.* Include ''[Your name] Comments on Flood Insurance, Interagency Questions & Answers'' in the e-mail subject line.
- *Fax:* (703) 518–6319. Use the subject line described above for e-mail.
- *Mail:* Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.
- *Hand Delivery/Courier:* Same as mail address.

Public Inspection: All public comments are available on the agency's Web site at *http://www.ncua.gov/RegulationOpinionsLaws/comments* as submitted, except as may not be possible for technical reasons. Public comments will not be edited to remove any identifying or contact information. Paper copies of comments may be inspected in NCUA's law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9 a.m. and 3 p.m. To make an appointment, call (703) 518–6546 or send an e-mail to *OGCMail@ncua.gov.*

FOR FURTHER INFORMATION CONTACT:

OCC: Pamela Mount, National Bank Examiner, Compliance Policy, (202) 874–4428; or Margaret Hesse, Special Counsel, Community and Consumer Law Division, (202) 874–5750, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

Board: Vivian Wong, Senior Attorney, Division of Consumer and Community Affairs, (202) 452–2412; Tracy Anderson, Senior Supervisory Consumer Financial Services Analyst (202) 736–1921; or Brad Fleetwood, Senior Counsel, Legal Division, (202) 452–3721, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. For the deaf, hard of hearing, and speech impaired only, teletypewriter (TTY), (202) 263–4869.

FDIC: Mira N. Marshall, Chief, Compliance Policy Section, Division of Supervision and Consumer Protection, (202) 898–3912; or Mark Mellon, Counsel, Legal Division, (202) 898–3884, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429. For the hearing impaired only, telecommunications device for the deaf TDD: 800–925–4618.

OTS: Ekita Mitchell, Consumer Regulation Analyst, (202) 906–6451; or Richard S. Bennett, Senior Compliance Counsel, (202) 906–7409, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

FCA: Mark L. Johansen, Senior Policy Analyst, Office of Regulatory Policy, (703) 993–4498; or Mary Alice Donner, Attorney Advisor, Office of General Counsel, (703) 883–4033, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102–5090. For the hearing impaired only, TDD (703) 883–4444.

NCUA: Justin M. Anderson, Staff Attorney, Office of General Counsel, (703) 518–6540; or Pamela Yu, Staff Attorney, Office of General Counsel, (703) 518–6593, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

SUPPLEMENTARY INFORMATION:

Background

The National Flood Insurance Reform Act of 1994 (the Reform Act) (Title V of the Riegle Community Development and Regulatory Improvement Act of 1994) comprehensively revised the two Federal flood insurance statutes, the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973. The Reform Act required the OCC, Board, FDIC, OTS, and NCUA to revise their flood insurance regulations and required the FCA to promulgate a flood insurance regulation for the first time. The OCC, Board, FDIC, OTS, NCUA, and FCA (collectively, ''the Agencies'') fulfilled these requirements by issuing a joint final rule in the summer of 1996. *See* 61 FR 45684 (August 29, 1996).

In connection with the 1996 joint rulemaking process, the Agencies received a number of requests to clarify specific issues covering a wide spectrum of the proposed rule's provisions. The Agencies addressed many of these requests in the preamble to the joint final rule. The Agencies concluded, however, that given the

number, level of detail, and diversity of the requests, guidance addressing the technical compliance issues would be helpful and appropriate. Consequently, the Agencies decided to issue guidance to address these technical issues subsequent to the promulgation of the final rule (61 FR at 45685–86). The Federal Financial Institutions Examination Council (FFIEC) fulfilled that objective through the initial release of the Interagency Questions and Answers in 1997 (1997 Interagency Questions and Answers). 62 FR 39523 (July 23, 1997).

In response to issues that had been raised, the Agencies, in coordination with the Federal Emergency Management Agency (FEMA), released for public comment proposed revisions to the 1997 Interagency Questions and Answers. 73 FR 15259 (March 21, 2008) (March 2008 Proposed Interagency Questions and Answers). Among the changes the Agencies proposed were the introduction of new questions and answers in a number of areas, including second lien mortgages, the imposition of civil money penalties, and loan syndications/participations. The Agencies also proposed substantive modifications to questions and answers previously adopted in the 1997 Interagency Questions and Answers pertaining to construction loans and condominiums. Finally, the Agencies proposed to revise and reorganize certain of the existing questions and answers to clarify areas of potential misunderstanding and to provide clearer guidance to users.

The Agencies received and considered comments from 59 public commenters, and are now adopting the Interagency Questions and Answers, comprising 77 questions and answers, revised as appropriate based on comments received. The Agencies made nonsubstantive revisions to certain answers upon further consideration either to more directly respond to the question asked or to provide additional clarity. The Agencies are also proposing five new questions and answers for public comment. These Interagency Questions and Answers supersede the 1997 Interagency Questions and Answers and supplement other guidance or interpretations issued by the Agencies and FEMA.

For ease of reference, the following terms are used throughout this document: ''Act'' refers to the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as revised by the National Flood Insurance Reform Act of 1994 (codified at 42 U.S.C. 4001 *et seq.*). ''Regulation'' refers to each agency's current final flood insurance rule.[1]

Section-by-Section Analysis

Section I. Determining When Certain Loans Are Designated Loans for Which Flood Insurance Is Required Under the Act and Regulation

The Agencies proposed this new section to address specific circumstances a lender may encounter when deciding whether a loan should be a designated loan for purposes of flood insurance. The proposed new section was intended to replace the previous section I in the 1997 Interagency Questions and Answers entitled ''Definitions'' and to incorporate existing questions from other sections addressing this topic and two new questions.

Proposed question and answer 1 addressed the applicability of the Regulation to loans made in a nonparticipating community. One commenter suggested the Agencies mention that a lender may choose to require private flood insurance per its loan agreement with the borrower, for buildings or mobile homes located outside a community in the National Flood Insurance Program (NFIP). The Agencies agree that lenders have such discretion, but do not believe that the question and answer requires further elaboration. Another commenter suggested the Agencies mention that Government Sponsored Enterprises (GSEs), such as Fannie Mae and Freddie Mac, may not purchase loans made on properties in a Special Flood Hazard Area (SFHA) in communities that do not participate in the NFIP. The Act does require GSEs to have procedures in place to ensure that purchased loans are in compliance with the mandatory purchase requirements. The Agencies do not believe that further elaboration is necessary and adopt the question and answer as proposed.

Proposed question and answer 2 explained that, upon a FEMA map change that results in a building or mobile home securing a loan being removed from an SFHA, a lender is no longer obligated to require mandatory flood insurance. However, the lender may choose to continue to require flood insurance for risk management purposes. The Agencies received one comment from an industry group suggesting the guidance in proposed question and answer 2 be amended to add language encouraging lenders to promptly remove the flood insurance requirement from a loan when the building or mobile home securing the loan is removed from an SFHA by way of a map change. The decision to require flood insurance in these instances is typically made on a case-by-case basis, depending on a lender's risk management practices. The Agencies do not believe that a blanket statement encouraging lenders to remove flood insurance in such instances is an appropriate position; therefore, the question and answer is adopted as proposed.

Proposed question and answer 3 addressed whether a lender's purchase of a loan, secured by a mobile home or building located in an SFHA in which flood insurance is available under the Act, from another lender triggers any requirements under the Regulation. The Agencies received several comments opposing the reference to safety and soundness necessitating a due diligence review prior to purchasing the loan. The Agencies note that although lenders are not required to review loans for flood insurance compliance prior to purchase, depending upon the circumstances, safety and soundness considerations may sometimes necessitate such due diligence. As such, the Agencies do not concur with the commenter's opposition and adopt question and answer 3 as proposed.

The Agencies are adopting a new question and answer 4 addressing syndicated and participation loans following question and answer 3, which deals with purchased loans, to emphasize the need for similar treatment of purchased loans and syndicated and participation loans. The new question and answer was initially proposed as question and answer 40 under section VIII. Proposed section VIII on loan syndications and participations and the accompanying question and answer are removed and the remaining sections are renumbered accordingly.

Proposed question and answer 40 explained that, with respect to loan syndications and participations, individual participating lenders are responsible for ensuring compliance with flood insurance requirements. The proposed answer further explained that participating lenders may fulfill this obligation by performing upfront due diligence to ensure that the lead lender or agent has undertaken the necessary activities to make sure that appropriate flood insurance is obtained and has adequate controls to monitor the loan(s) on an on-going basis.

The Agencies received several comments from financial institutions and industry trade groups opposing the

[1] The Agencies' rules are codified at 12 CFR part 22 (OCC), 12 CFR part 208 (Board), 12 CFR part 339 (FDIC), 12 CFR part 572 (OTS), 12 CFR part 614 (FCA), and 12 CFR part 760 (NCUA).

Copyright © 2009 Association of Corporate Counsel

differences between the guidance in proposed question and answer 3 regarding the purchase of a loan and the guidance in proposed question and answer 40. A majority of the commenters argued that loan participations and syndications should be treated the same as other loan purchases for purposes of flood insurance. Several of these commenters suggested that the Agencies' proposed treatment of loan syndications and participations appeared to be inconsistent with proposed question and answer 3 pertaining to purchased loans.

In response to these comments, the Agencies are revising the relevant question and answer to reflect that, as with purchased loans, the acquisition by a lender of an interest in a loan either by participation or syndication, after that loan has been made, does not trigger the requirements of the Act and Regulation, such as making a new flood determination or requiring a borrower to purchase flood insurance. Nonetheless, as with purchased loans, depending upon the circumstances, safety and soundness considerations may sometimes necessitate that the lender undertake due diligence to protect itself against the risk of flood or other types of loss.

If a regulated lender is involved in the making of the underlying loan, but does not purchase a loan participation or syndication after the loan has been made, the flood requirements of the Act and Regulation would apply to the lender. The Agencies believe that lenders who pool or contribute funds that will be advanced simultaneously to a borrower as a loan secured by improved real estate would *all* be considered to have ''made'' the loan under the Act and Regulation. In such circumstances, each participating lender in a loan participation or syndication is responsible for compliance with the Act and Regulation. This does not mean that each participating lender must separately obtain a flood determination or monitor whether flood insurance premiums are paid. Rather, it means that each participating lender subject to Federal flood insurance requirements should perform upfront due diligence to ensure both that the lead lender or agent has undertaken the necessary activities to make sure that the borrower obtains appropriate flood insurance and that the lead lender or agent has adequate controls to monitor the loan(s) on an on-going basis for compliance with the flood insurance requirements. The participating lender should require as a condition to the loan-sharing agreement that the lead lender or agent will provide participating lenders with sufficient information on an ongoing basis to monitor compliance with flood insurance requirements. A written representation provided by the lead lender or syndication agent certifying that the borrower has obtained appropriate flood insurance would be sufficient. Alternatively, the lead lender or syndication agent could provide participants and syndication lenders with a copy of the declaration page or other proof of insurance. The Agencies have incorporated minor revisions to the question and answer to clarify this guidance.

Proposed question and answer 4 (final question and answer 5) addressed the applicability of the Regulation to loans being restructured because of the borrower's default on the original loan. In light of the many loan modifications being made, the Agencies have revised the question to address loan modifications as well as loans being restructured because of the borrower's default on the original loan. The guidance provided in the answer is applicable to either situation. The Agencies received one comment asking whether capitalization of a loan in the event of a default would constitute an increase in the loan, triggering the requirements of the Regulation. If the capitalization results in an increase in the outstanding principal balance of the loan, then the requirements of the Regulation will apply. Conversely, a loan restructure that does not result in an increase in the amount to the loan (or an extension of the term of the loan) will not trigger the requirements of the Regulation. The Agencies do not believe further elaboration addressing this comment is necessary. The Agencies adopt the question and answer as proposed with the changes made to include loan modifications, as well as restructuring of loans.

Proposed question and answer 5 (final question and answer 6), addressed whether table funded loans are treated as new loan originations. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

Proposed question and answer 6 (final question and answer 7) explained that a lender is not required to perform a review of its existing loan portfolio for purposes of the Act or Regulation; however, sound risk management practices may lead a lender to conduct periodic reviews. The Agencies received several comments opposing the reference to safety and soundness necessitating a due diligence review of a lender's portfolio. Although lenders are not required to review existing loan portfolios for flood insurance compliance under the Act or Regulation, the Agencies believe safety and soundness considerations may sometimes necessitate such due diligence and therefore adopt the question and answer as proposed.

Section II. Determining the Appropriate Amount of Flood Insurance Required Under the Act and Regulation

The Agencies proposed this section to provide guidance on how lenders should determine the appropriate amount of flood insurance to require the borrower to purchase. The Agencies received numerous comments on this proposed section. As a result of these comments, the Agencies have made both significant revisions to proposed questions and answers as well as proposed new questions and answers submitted for comment to provide greater clarity on this important area. The proposed new questions and answers are addressed in the **SUPPLEMENTARY INFORMATION** immediately following the Redesignation Table.

Proposed question and answer 7 (final question and answer 8) addressed what is meant by the ''maximum limit of coverage available for the particular type of property under the Act.'' The first part of the question and answer discussed the maximum caps on insurance available under the Act. The Agencies did not receive any substantive comments on this part of the question and answer and adopt it as proposed in final question and answer 8. The second part of the question and answer discussed the maximum limits on the coverage in the context of the regulation that provides that ''flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the property is located,'' commonly referred to as insurable value. In response to the numerous comments received on the insurable value part of the proposed question and answer, the Agencies are proposing new questions and answers 9 and 10 for public comment. The Agencies otherwise adopt question and answer 7 (final question and answer 8) as proposed.

Proposed questions and answers 8 and 9 (final questions and answers 11 and 12 respectively) more fully defined the terms ''residential building'' and ''nonresidential building.'' One commenter suggested that the Agencies define residential and nonresidential buildings based on the percentage of the building used in a certain way to account for mixed use buildings.

Copyright © 2009 Association of Corporate Counsel

Proposed question and answer 8 (final question and answer 11) provides that a residential building may have incidental nonresidential use as long as such incidental use is limited to less than 25 percent of the square footage of the building. A mixed use residential building where greater than 25 percent of the square footage of the building is devoted to incidental nonresidential use will be considered a nonresidential building. Proposed question and answer 9 (final question and answer 12) provides that a mixed use nonresidential building with less than 75 percent of the square footage of the building used for residential purposes will still be considered nonresidential. The commenter also asked whether a farm house is residential or nonresidential. If the farmhouse is used as a dwelling, then it will be considered residential.

Another commenter asked whether a lender is obligated to determine the amount of nonresidential use in a residential building and whether there are any record maintenance requirements. Typically, whether a building is nonresidential or residential is of most importance in determining the maximum limits of a general property form NFIP policy. A residential building covered under a general property form will have a maximum coverage limit of $250,000, while a nonresidential building covered under the same type of policy will have a maximum coverage limit of $500,000. Therefore, the lender needs to know whether the building is considered residential or nonresidential when it determines the amount of flood insurance coverage to require. Finally, a commenter asked whether a designated loan, secured by a residential building and a detached nonresidential building, such as a garage, would require separate nonresidential coverage on the detached nonresidential building. If the residential building is a one-to-four family dwelling that is covered by a dwelling form NFIP policy, that policy will cover a detached garage at the same location as the dwelling, up to 10 percent of the limit of liability on the dwelling, so long as the detached garage is not used or held for use as a residence, a business or for farming purposes. In other cases, the lender must require the borrower to obtain coverage for each building securing the loan. The Agencies believe no further clarification is necessary and adopt the questions and answers as proposed.

Proposed question and answer 10 (final question and answer 13) illustrated how to apply the ''maximum limit of coverage available for the particular type of building under the Act.'' The majority of the comments received are addressed in the discussion below pertaining to new proposed questions and answers 9 and 10. The Agencies adopt question and answer 10 (final question and answer 13) as proposed.

Proposed questions and answers 11 and 12 (final questions and answers 14 and 15 respectively) were originally adopted in the 1997 Interagency Questions and Answers. The changes proposed by the Agencies in March 2008 were designed to provide greater clarity with no intended change in substance and meaning.

Four commenters addressed proposed question and answer 11, which dealt with flood insurance requirements where a designated loan is secured by more than one building. One commenter supported the proposed question and answer, but suggested that where the collateral is worthless and would not be replaced, lenders should not have to require the borrower to obtain flood insurance. The Agencies are proposing questions 9 and 10 for public comment to address the issue of determining insurable value for certain nonresidential buildings that include certain low-value nonresidential buildings. Another commenter asked whether a lender would be liable if the lender allocates the overall required flood insurance over several buildings and one building suffers flood damage and is underinsured. In such a circumstance, the lender would have complied with the Act and the Regulation. Of course, the lender has the option to require the borrower to obtain more flood insurance coverage than the minimum amount required if the lender believes there is a high risk of flood loss (*see* final question and answer 16). Two commenters suggested that the Agencies should explain how the lender should allocate the required amount of coverage for multiple buildings of different values that secure a single loan. One of these commenters suggested that allocation could be made by a square footage method. The Agencies agree that this is one reasonable method that could be used. Other methods may include a value-based method, splitting the total coverage pro rata based on replacement cost value, or a functionality method, requiring a higher proportional share of coverage to those buildings that are most important to the ongoing operation of the borrower. The apportionment of the required coverage in any particular situation should reflect consideration by both the lender and borrower of their needs and risks. The Agencies believe no further clarification is necessary but revised the answer to address the technical issue that single-family dwellings are considered residential if less than 50 percent of the square footage is used for an incidental nonresidential purpose.

Twenty commenters addressed proposed question and answer 12, which addressed the flood insurance requirements where the insurable value of a building securing a designated loan is less than the outstanding principal balance of the loan. The comments generally raised concerns about the lack of a definition of ''insurable value,'' discussed above in connection with proposed question and answer 7. As previously mentioned, the Agencies are proposing new questions and answers 9 and 10 for public comment to address the issue of insurable value. One commenter also asked whether the Agencies will require a lender to review flood insurance policies annually at renewal and increase coverage as the replacement cost value increases. The Agencies typically will not require such a review. However, if at any time during the term of the loan, the lender determines that flood insurance coverage is insufficient, the lender must comply with the force placement procedures in the Regulation. The Agencies believe no further clarification is necessary and adopt the question and answer as proposed.

Proposed question and answer 13 (final question and answer 16) clarified that a lender can require more flood insurance than the minimum required by the Regulation. The Regulation requires a minimum amount of flood insurance; however, lenders may require more coverage, if appropriate. Two commenters asked the Agencies to specify that lenders may never require coverage that exceeds the insurable value of a building. As stated in the question and answer, lenders should avoid creating situations where a building is over-insured. Further, the Agencies state in final question and answer 8 that ''an NFIP policy will not cover an amount exceeding the insurable value of the structure.'' Another commenter asked what penalties, if any, would be imposed on a lender that requires over insurance. The Agencies note that there are no penalties for over insurance under the Act and Regulation. However, there may be penalties for over-insurance under applicable State law. Finally, a commenter suggested that flood insurance should not be required where the collateral building is worthless and would not be replaced. The Agencies are proposing questions 9 and 10 for public comment to address the issue of

Copyright © 2009 Association of Corporate Counsel

determining insurable value for certain nonresidential buildings that include certain low value nonresidential buildings. Other than a nonsubstantive revision to provide additional clarity, the Agencies adopt the question and answer as proposed.

Proposed question and answer 14 (final question and answer 17) addressed lender considerations regarding the amount of the deductible on a flood insurance policy purchased by a borrower. Generally, the proposed guidance advised a lender to determine the reasonableness of the deductible on a case-by-case basis, taking into account the risk that such a deductible would pose to the borrower and lender. The Agencies received nine comments addressing proposed question and answer 14. Four commenters suggested that borrowers with low-value buildings should be able to choose a deductible that exceeds the value of the building with a result that flood insurance would not be required. The Act and Regulation require flood insurance on all buildings at the lesser of the outstanding principal balance of the loan or the maximum amount available under the Act. A high deductible does not provide a de facto waiver of this requirement. One commenter suggested that the Agencies' position regarding not allowing a de facto waiver of the flood insurance requirement on low-value buildings based on the deductible amount contradicts the NFIP's policy of following the standard practice in the financial industry of allowing lenders to dictate the amount of the deductible according to the authority found in the loan agreement. Other commenters stated that a lender should not be required to determine deductibles on a case-by-case basis but rather through adoption of credit guidelines that apply across-the-board to all loans. In general, the Agencies agree that lenders may adopt credit guidelines that apply to most loans. However, such guidelines cannot work to waive the flood insurance requirements of the Act and Regulation. Finally, one commenter suggested that the Agencies should mention that the GSEs may have maximum allowable deductibles. The Agencies decline to revise the question and answer based on this comment because information about GSE requirements is outside the scope of this guidance. The Agencies adopt the question and answer as proposed.

Section III. Exemptions From the Mandatory Flood Insurance Requirements

This section contains only one question and answer, which describes the statutory exemptions from the mandatory flood insurance requirements. Proposed question and answer 15 (final question and answer 18) was revised from the 1997 Interagency Questions and Answers to provide greater clarity, with no intended change in substance or meaning. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

Section IV. Flood Insurance Requirements for Construction Loans

The Agencies proposed this new section to clarify the requirements regarding the mandatory purchase of flood insurance for construction loans to erect buildings that will be located in an SFHA in light of concerns raised by some regulated lenders regarding borrowers' difficulties in obtaining flood insurance for construction loans at the time of loan origination. The Agencies received a number of comments on the proposed questions and answers concerning construction loans. Several commenters asked for guidance in determining the appropriate amount of flood insurance for a loan secured by a building during the course of construction. This guidance is provided in the discussion of the proposed new questions and answers 9 and 10 for public comment that addresses insurable value.

Proposed question and answer 16 (final question and answer 19) revises existing guidance to limit its scope and explained that a loan secured only by land located in an SFHA is not a designated loan that would require flood insurance coverage. The Agencies received one comment addressing this question and answer from a financial institution commenter that asked whether a loan secured by developed land without a structure on it, which, during the course of the loan, will not have any structure on it, necessitates a flood determination as it is considered residential real estate. The Agencies believe that the commenter has raised a valid point and have revised the proposed question and answer by removing the reference to ''raw'' land. The revised question and answer discusses loans secured only by ''land.'' Since a designated loan is a loan secured by a building or mobile home that is located or to be located in an SFHA, any loan secured only by land that is located in an SFHA is not a designated loan since it is not secured by a building or mobile home. In the case of this particular comment, the loan is not secured by either a building or mobile home; therefore, it is not a designated loan. The Agencies adopt the question and answer as proposed with the modification described above.

Proposed question and answer 17 (final question and answer 20) addressed whether a loan secured or to be secured by a building in the course of construction that is located or to be located in an SFHA in which flood insurance is available under the Act is a designated loan. The proposed answer provided that a lender must make a flood determination prior to loan origination for a construction loan. If the flood determination shows that the building securing the loan will be located in an SFHA, the lender must provide notice to the borrower, and must comply with the mandatory purchase requirements.

One financial institution commenter asked whether the lender/servicer must provide continuing flood insurance coverage where a structure in an SFHA covered by flood insurance is considered a total loss/demolished and only the land remains and the structure is to be rebuilt. The Agencies believe that if there is remaining insurable value in the building, flood insurance should continue to be maintained. If the building has no remaining insurable value, then flood insurance is not required. Under these circumstances, the total loss situation is akin to a loan secured only by land located in an SFHA, which is addressed in final question and answer 19 discussed above, and is not a designated loan that would require flood insurance coverage. If the building is a total loss/demolished and has no remaining insurable value, but a new structure is going to be built in its place, it should be treated like a new construction loan as discussed below in proposed question and answer 19 (final question and answer 22). To the extent that any new structure that will be built is, or will be, located in an SFHA, then the lender must provide notice to the borrower, and must comply with the mandatory purchase requirements as outlined in proposed questions and answers 18 and 19 (final questions and answers 21 and 22). The lender can, of course, elect to maintain the flood insurance that had previously been in place on the prior demolished structure to avoid having to monitor the reconstruction as discussed below.

Another financial institution commenter asked whether a building in the course of construction that will be a condominium building when finished can be insured under a Residential Building Condominium Association Policy (RCBAP) during the construction period. The RCBAP can be sold to a condominium association only. Therefore, unless the building is under

Copyright © 2009 Association of Corporate Counsel

the condominium form of ownership with a condominium association formed at the time of construction, no RCBAP can be written. If there is no condominium association, the lender should require the builder/developer to obtain flood insurance under the NFIP General Property form or private equivalent. If the building will be a residential condominium, then the lender must require flood insurance to meet the statutory requirements, up to the $250,000 flood insurance limit under the NFIP for an ''other residential'' building.

Finally, a loan servicer commenter asked the Agencies to clarify when flood insurance coverage takes effect when a lender opts to require flood insurance at origination of a construction loan. This comment is addressed in final question and answer 21. The Agencies adopt the final question and answer 20 as proposed.

Proposed question and answer 18 (final question and answer 21) explained that, generally, a building in the course of construction is eligible for coverage under an NFIP policy, and that coverage may be purchased prior to the start of construction. One financial institution commenter asked whether the definition of a ''building'' in the proposed question and answer has the same meaning as FEMA's definition in its *Mandatory Purchase of Flood Insurance Guidelines.*[2] The Agencies believe that the definitions of ''building,'' as well as the definition of ''building in the course of construction,'' used by FEMA are fully consistent with the definition in the Regulation. The Agencies adopt the question and answer as proposed with only minor clarifications to the citation of FEMA's *Flood Insurance Manual.*

Proposed question and answer 19 (final question and answer 22), addressed when flood insurance must be purchased for buildings under the course of construction. The answer provided lenders with flexibility regarding the timing of the mandatory purchase requirement for construction loans in response to concerns raised by lenders that borrowers have encountered difficulties in obtaining flood insurance for construction loans at the time of origination. Specifically, the Agencies proposed to permit lenders to allow borrowers to defer the purchase of flood insurance until a foundation slab has been poured and/or an elevation certificate has been issued. Lenders choosing this option, however, must require the borrower to have flood insurance in place before funds are disbursed to pay for building construction on the property securing the loan (except as necessary to pour the slab or perform preliminary site work). A lender who elects this approach and does not require flood insurance at loan origination must have adequate internal controls in place to ensure compliance. Moreover, lenders must still ensure that the required flood determination is completed at origination and that notice is given to borrowers if the property is located in an SFHA.

A financial institution and a financial institution membership organization commented that requiring lenders to have monitoring procedures in place to ensure that the borrower obtains flood insurance as soon as the foundation is complete or the elevation certificate issued is too burdensome. The Agencies note that if a lender determines that this option is too burdensome they may continue the practice of requiring flood insurance at origination. The monitoring procedures are only necessary in the event that lenders choose to require flood insurance at the time the foundation pad is completed and/or the elevation certificate is obtained. Therefore, the Agencies believe that no revision to the proposed question and answer is necessary.

Several commenters, including four financial institutions and a law firm that advises financial institutions, asked the Agencies for clarification regarding the ''timing'' options available for determining whether flood insurance is required for buildings in the course of construction, that is, the foundation alone and/or the issuance of an elevation certificate. Either the pouring of the foundation slab or the issuance of an elevation certificate provides sufficient information for a lender to determine whether the collateral building is located in an SFHA for which flood insurance is required. The Agencies believe that no further elaboration is necessary to address this issue in the question and answer.

Finally, one individual commenter indicated that it is unclear whether an NFIP policy can be purchased before two walls and a roof have been erected. FEMA guidance provides that buildings yet to be walled and roofed are generally eligible for coverage after an elevation certificate is obtained or a foundation slab is poured, except where either construction is halted for more than 90 days or if the lowest floor used for rating purposes is below Base Flood Elevation (BFE). If the lowest floor is under BFE, then the building must be walled and roofed before flood insurance coverage is available.[3] The Agencies believe that the commenter has raised a valid point and have clarified the proposed question and answer accordingly. The Agencies otherwise adopt the question and answer as proposed.

The Agencies also proposed new question and answer 20 (final question and answer 23) to clarify whether the 30-day waiting period for an NFIP policy applies when the purchase of flood insurance is deferred in connection with a construction loan since there has been confusion among lenders on this issue in the past. Per guidance from FEMA, the answer provided that the 30-day waiting period would not apply in such cases.[4] The NFIP would rely on the insurance agent's representation that the exception applies unless a loss has occurred during the first 30 days of the policy period. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

Section V. Flood Insurance Requirements for Nonresidential Buildings

The Agencies proposed this new section to address the flood insurance requirements for agricultural buildings that are taken as security for a loan, but that have limited utility to a farming operation, and loans secured by multiple buildings where some are located in an SFHA and others are not. Six commenters suggested that this section should be broadened to include all nonresidential buildings, including multiple nonresidential buildings over a large geographic area, not just those related to agriculture. The Agencies concur and have changed the title to section V to read ''Flood Insurance Requirements for Nonresidential Buildings'' and modified proposed questions and answers 21 and 22 (final question and answers 24 and 25) accordingly. Several commenters asked for guidance in determining the appropriate amount of flood insurance for loans secured by a nonresidential building, particularly for nonresidential buildings of low to no value. The Agencies are proposing questions 9 and 10 for public comment to address the issue of determining insurable value for certain nonresidential buildings that include certain low value nonresidential buildings.

[2] FEMA, Mandatory Purchase of Flood Insurance Guidelines (September 2007) at GLS—1–2. FEMA has made this booklet available electronically at *http://www.fema.gov/library/viewRecord.do?id=2954.* Hard copies are available by calling FEMA's Publication Warehouse at (800) 480–2520.

[3] FEMA, Mandatory Purchase of Flood Insurance Guidelines, at 30–31.

[4] FEMA, Mandatory Purchase of Flood Insurance Guidelines, at 30.

Federal Register / Vol. 74, No. 138 / Tuesday, July 21, 2009 / Notices 35921

Proposed question and answer 21 (final question and answer 24) explained that all buildings taken as security for a loan and located in an SFHA require flood insurance. The question and answer also explained that lenders may consider ''carving out'' a building from the security for a loan; however, it may be inappropriate for credit risk management reasons to do so. One commenter questioned whether lenders need to require flood insurance when the collateral is only a building (in the commenter's case, a grain bin) and not the real property where the building is located. Further, the commenter stated that they only use a UCC fixture filing to secure the building. Flood insurance is required for any building taken as collateral when that building is located in an SFHA in a participating community. This requirement is not predicated on whether the underlying real estate is also included in the loan collateral or the method used by the lender to secure its collateral. FEMA answered the question of whether a grain bin is a building by specifically including a grain bin in its definition of a nonresidential building, therefore flood insurance is required.[5]

A commenter stated that if the value of a building is worthless or nearly zero then flood insurance should not be required. The Act requires all buildings located in an SFHA and in a participating community to have flood insurance with only two exemptions— when a building is State-owned and covered by self-insurance satisfactory to the Director of FEMA; and when the original loan balance is $5,000 or less and the original repayment term is one year or less. All other buildings are required to be covered by flood insurance. The Agencies are proposing questions 9 and 10 for public comment to address the issue of determining insurable value for certain nonresidential buildings that include certain low value nonresidential buildings.

Another commenter suggested that in determining ''insurable value,'' institutions should be permitted to place good faith reliance on insurance agents who are better equipped to make these determinations. Federally regulated lenders may solicit assistance when evaluating insurable value and this assistance could include an insurance professional. However, it is ultimately the lender's responsibility to determine the insurable value of a building and, as such, it must concur with the determination. The same commenter also asked the Agencies to explain the rationale for treating hazard insurance and flood insurance differently. The reason for treating flood insurance and hazard insurance differently is that flood insurance includes coverage for the repair or replacement cost of the foundation and supporting structures whereas hazard insurance typically does not include coverage of the foundation. Therefore, the calculation of insurable value for flood insurance includes these repair or replacement costs while the calculation of insurable value for hazard insurance does not.

Lastly, a commenter suggested that the Agencies include additional questions and answers about other problems that arise between lenders and insurance companies, such as insurance companies requiring higher amounts of coverage than the appraised value of a structure of minimal value. The amount of flood insurance required by the Act is the lesser of the outstanding principal balance of the loan, the maximum allowed under the Act, or the insurable value. The appraised market value of the structure is not a factor in determining the amount of required insurance. The Agencies adopt question and answer 21 with the changes made to include all nonresidential buildings and not just agricultural buildings.

Proposed question and answer 22 (final question and answer 25) addressed the flood insurance requirements for multiple agricultural buildings located throughout a large geographic area, some in an SFHA and some not. One commenter suggested that the Agencies modify the first sentence in the proposed answer to refer to ''improved property'' rather than ''property.'' The Agencies concur with this recommendation and have inserted ''improved real estate'' in the place of the term ''property'' throughout the answer. The term ''improved real estate,'' instead of the suggested ''improved property,'' was added because it is the term used in the Act.

A commenter asked the Agencies to address the situation where an insurance company requires flood insurance on all buildings on the property, not just those inside an SFHA and another commenter asked the Agencies to mention that a lender can require flood insurance on buildings not located in an SFHA. The Act does not prohibit a lender from requiring more flood insurance than the minimum required by the Act; a lender may have legitimate business reasons for requiring more flood insurance than that required by the Act and neither the Act nor the Regulation prohibits this additional flood insurance. Finally, a commenter suggested that the Agencies modify the second to last sentence in the answer to refer to ''improved property securing the loan'' rather than ''designated loan.'' The Agencies have deleted this sentence entirely as it is not needed to answer the question. The Agencies adopt the question and answer with the modifications discussed above.

Section VI. Flood Insurance Requirements for Residential Condominiums

The Agencies proposed this new section to address flood insurance requirements for residential condominiums. The proposed section contained two previously existing questions and answers, which were modified and expanded, and five new questions and answers. The Agencies received numerous comments addressing this section.

A number of commenters addressed the 2007 FEMA requirement that insurance companies providing a Residential Building Association Policy (RCBAP) include the replacement cost value of the condominium building and the number of units in the building on the declaration page.[6] Two commenters suggested that the Agencies should enforce this requirement over all insurance companies. The Agencies strongly support this FEMA requirement; however, the Agencies may only enforce the requirement against those entities over which the Agencies have jurisdiction.

Proposed question and answer 23 (final question and answer 26) explained that residential condominiums were subject to the statutory and regulatory requirements for flood insurance. The Agencies received only one comment addressing this question and answer, which was in agreement with the guidance. The Agencies adopt the question and answer as proposed.

One commenter suggested that an RCBAP should be described in a separate question and answer in this section. Although the RCBAP was described within the proposed questions and answers, the Agencies have compiled the information from proposed questions and answers 24 and 25 into new question and answer 27 to specifically describe an RCBAP, and renumbered the remaining questions and answers accordingly.

Proposed question and answer 24 (final question and answer 28)

[5] FEMA, Flood Insurance Manual, GR 2.

[6] FEMA Memorandum for Write Your Own (WYO) Principal Coordinators and NFIP Servicing Agent (Apr. 18, 2004) (subject: Oct. 1, 2007 Program changes).

Copyright © 2009 Association of Corporate Counsel

discussed the amount of flood insurance that a lender must require with respect to residential condominium units to comply with the mandatory purchase requirements under the Act and the Regulation. The Agencies received a number of comments addressing various aspects of this question and answer.

Several commenters suggested that lenders should be able to rely on the replacement cost value and number of units provided on the declaration page of the RCBAP in determining the insurable value of a condominium unit. The Agencies generally agree that a lender may rely on the replacement cost value and number of units provided on the declaration page unless it has reason to believe that such amounts conflict with other available information. If there is a conflict, the lender should notify the borrower of the facts that cause the lender to believe there is a conflict. If the lender believes that the borrower is underinsured, it should require the purchase of a Dwelling Policy for supplemental coverage. The Agencies have modified the question and answer accordingly.

Several commenters asked about other types of valuation information that may be appropriate to use in determining the insurable value of a condominium unit when the insurance provider does not include the replacement cost value and number of units on the RCBAP's declaration page. While the Agencies believe that the question and answer does not require further elaboration on this point, the Agencies note that consistent with safe and sound lending practices, lenders should maintain information about the value of their collateral. Even if the insurance provider does not include the replacement cost value of the condominium building and the total number of units on the declaration page, lenders typically have other sources of valuation information, including cost-approach appraisals, automated valuation systems, and tax assessments. Further, many lenders' policies and procedures include obtaining specific documentation related to condominium collateral that may provide information about the condominium's insurable value, including copies of condominium master insurance policies or the declaration pages of such policies. The Agencies generally will not criticize a lender that, in good faith, has used a reasonable method to determine the insurable value.

Several commenters agreed that RCBAP coverage written at replacement cost value, assuming that value is less than the outstanding principal amount of the loan or the maximum available under the Act, is the appropriate insurable value for a condominium building and that an RCBAP with that coverage would meet the mandatory purchase requirement for an individual unit borrower. The 1997 Interagency Questions and Answers stated that RCBAP coverage of 80 percent of replacement cost value was sufficient to meet the mandatory purchase requirement. Because of this change in policy, commenters urged the Agencies to ensure that the new guidance will apply only prospectively. Consistent with the stated intention in the March 2008 Proposed Interagency Questions and Answers, the Agencies intend that this guidance will apply to any loan that is made, increased, extended, or renewed on or *after* the effective date of these Interagency Questions and Answers.

The Agencies had previously indicated in the **SUPPLEMENTARY INFORMATION** to the March 2008 Proposed Interagency Questions and Answers that the new guidance would apply to a loan made prior to the effective date of this guidance, but only as of the first flood insurance policy renewal following the effective date of the guidance. Three commenters asked the Agencies to reconsider this position. The commenters asserted that lenders making loans secured by individual condominium units generally do not receive RCBAP renewal notifications from the insurance providers; therefore, the lender may not be in a position to make a determination at the first RCBAP renewal period following the effective date of this guidance.

Lenders are required to ensure that designated loans are covered by flood insurance for their term. However, the Agencies recognize that lenders made loans and required coverage amounts in reliance on the previous guidance. Therefore, the Agencies have agreed that the revised guidance will not apply to any loan made prior to the effective date of this guidance unless a trigger event occurs in connection with the loan (that is, the loan is refinanced, extended, increased, or renewed). Because the Agencies provided supervisory guidance that stated that an RCBAP with coverage at 80 percent of replacement cost value was sufficient, any loan for a condominium unit relying on an RCBAP with coverage that complied with that guidance was in compliance at the time it was made. Absent a new trigger event, the Agencies, therefore, will not require lenders to ensure that RCBAP coverage is increased to 100 percent on previously compliant loans made prior to the effective date of this new guidance. The Agencies have revised the proposed question and answer accordingly. The Agencies anticipate that the universe of loans affected by this policy will be relatively small and diminishing due to refinancing and other loan prepayments that typically occur in the first five years of a home mortgage.

Proposed question and answer 25 (final question and answer 29) addressed what a lender that makes a loan on an individual condominium unit must do if there is no RCBAP coverage. Three commenters addressed this question and answer. One commenter suggested that, in the example, the Agencies should clarify that the amount of insurance required is the ''minimum amount'' because that value ($175,000) is based on the principal amount of the loan, which is less than either the insurable value of the unit ($200,000) or the maximum amount available in a dwelling policy ($250,000). In response to this comment, the Agencies have added the qualifier ''at least'' before the amount of $175,000 to clarify that $175,000 is the minimum amount of insurance that must be required. As in other situations, a lender may require additional coverage.

Another commenter asked whether a unit owner's dwelling policy will respond at all if there is no RCBAP on the condominium building. Although this is a general insurance question that is outside the Agencies' purview, FEMA guidance provides that, when there is no RCBAP coverage on the condominium building, the unit owner's dwelling policy will respond to losses to improvements owned by the insured and to assessments charged by the condominium association, up to the building coverage limits of the dwelling policy purchased.[7] Finally, one other commenter suggested that, when a condominium association refuses to purchase an RCBAP, the lender should refuse to make a loan to a unit owner because the unit owner's dwelling policy is not adequate to protect the lender. The Agencies agree that there is risk to the lender in accepting a dwelling policy as protection for the collateral. However, this is a risk that the lender must weigh. Such policy, however, does fulfill the mandatory purchase requirement. The Agencies have amended the proposed question and answer to include additional discussion on dwelling policies in response to these comments. The

[7] *See* FEMA, Mandatory Purchase of Flood Insurance Guidelines at 48–49; FEMA Flood Insurance Manual at p. POL 8 (FEMA's Flood Insurance Manual is updated every six months).

Copyright © 2009 Association of Corporate Counsel

Agencies otherwise adopt the question and answer as proposed.

Proposed question and answer 26 (final question and answer 30) discussed what a lender must do if the condominium association's RCBAP coverage is insufficient to meet the mandatory purchase requirements for a loan secured by an individual residential condominium unit. Several commenters suggested changes to FEMA's flood insurance policies. It is beyond the Agencies' jurisdiction to address these suggestions, which are within the purview of FEMA. Interested parties should appropriately consult with FEMA concerning the actual operation of flood insurance policies.

Several other commenters noted that the purchase of a unit owner's dwelling policy may not provide adequate coverage to the unit owner or the lender as a supplement to an RCBAP providing insufficient coverage to meet the mandatory purchase requirement. As noted in the proposed question and answer, a dwelling policy may contain claim limitations; therefore, it is incumbent upon a lender to understand these limitations.

Several commenters also suggested that the Agencies should not put forth guidance encouraging lenders to apprise borrowers that there is risk involved when flood coverage is maintained under a unit owner dwelling policy along with an RCBAP that does not provide replacement cost coverage. The Agencies believe that although insurance professionals are in the best position to adequately explain the implications of such coverage, lenders should still be encouraged to alert their borrowers to the risk. FEMA's brochure, *National Flood Insurance Program: Condominium Coverage*, may provide some helpful information for borrowers. The Agencies adopt the question and answer as proposed.

Proposed question and answer 27 (final question and answer 31) discussed what a lender must do when it determines that a loan secured by a residential condominium unit is in a complex with a lapsed RCBAP. One commenter requested that the Agencies provide more guidance on the steps a lender should take to determine if there is a lapse in existing RCBAP coverage. As mentioned above, the Agencies are aware that, generally, a lender that is the mortgagee of a unit owner's loan would not receive notice that the condominium association's RCBAP has expired. However, if a trigger event occurs (that is, the lender makes, increases, extends, or renews a loan to the borrower secured by the unit) or if the lender otherwise makes a determination that the RCBAP has expired, then the lender will be required to follow the procedure outlined in final question and answer 28 and discussed above. The Agencies adopt the question and answer as proposed.

Proposed question and answer 28 (final question and answer 32) provided examples of how the co-insurance penalty applies when an RCBAP is purchased at less than 80 percent of replacement cost value, unless the amount of coverage meets the maximum coverage of $250,000 per unit. Two commenters asked about the purpose of this question and answer. The Agencies intended this question and answer to provide information on the topic to lenders. The Agencies adopt the question and answer as proposed.

Proposed question and answer 29 (final question and answer 33) addressed the major factors that are involved with coverage limitations of the individual unit owner's dwelling policy with respect to the condominium association's RCBAP coverage. One commenter asked the purpose of this question and answer and further asserted that lenders should not be required to explain to borrowers about the limitations in coverage. The Agencies intended this question and answer to be informative in nature and agree that insurance professionals are in a better position to explain policy limitations to their policyholders. The Agencies adopt the question and answer as proposed.

Section VII. Flood Insurance Requirements for Home Equity Loans, Lines of Credit, Subordinate Liens, and Other Security Interests in Collateral Located in an SFHA

Proposed Section VII addressed flood insurance requirements for home equity loans, lines of credit, subordinate liens, and other security interests in collateral located in an SFHA. The proposed questions and answers primarily proposed only minor wording changes or clarifications to questions and answers in the 1997 Interagency Questions and Answers without any change in the substance or meaning. Several commenters addressed questions and answers in this section.

Proposed question and answer 30 (final question and answer 34), addressed when a home equity loan is considered a designated loan that requires flood insurance. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

Proposed question and answer 31 (final question and answer 35), addressed when a draw against an approved line of credit secured by property located in an SFHA requires flood insurance. Nine commenters questioned the statement that a designated loan requires a flood determination when application is made for that loan. The commenters noted that under the Act and Regulation, a lender or its servicer is responsible for performing a flood determination upon the making, increase, extension, or renewal of a loan, and not when a loan application is submitted. They further noted that applications are often withdrawn and that lenders usually have a flood determination performed when they are reasonably certain that one of the previously listed ''trigger'' events (*e.g.*, the making or increasing) will occur. The commenters requested that this point be clarified. The Agencies agree with the commenters and are deleting the statement that a designated loan requires a flood determination when application is made for that loan. The Agencies otherwise adopt the question and answer as proposed.

Proposed question and answer 32 (final question and answer 36) addressed how much flood insurance is required when a lender makes a second mortgage secured by property located in an SFHA. Six commenters argued that a junior lienholder should not have to take senior liens into account when determining the required amount of flood insurance coverage. They asserted that the current requirement causes substantial cost and delay, resulting in an undue burden due to the need for either the junior lienholder or its servicer to engage in an expensive, time-consuming search for prior liens. One commenter contended that the question and answer should state that the amount of coverage for a junior lien would be 100 percent of the insurable value of the property. Alternatively, the same commenter suggested multiple flood insurance policies on buildings with multiple liens as a means to address the problem. On the other hand, one commenter believed that the question and answer should remind lenders to add secondary loans to any existing flood insurance policy's mortgagee clause. Three commenters requested more guidance on how and when a lienholder should determine the value of any other liens on improved collateral property. One of these mentioned closing or upon renewal of a loan as two possible dates for such activity.

The Agencies believe that, given the provisions of an NFIP policy, a lender cannot comply with Federal flood insurance requirements when it makes,

increases, extends, or renews a loan by requiring the borrower to obtain NFIP flood insurance solely in the amount of the outstanding principal balance of the lender's junior lien without regard to the flood insurance coverage on any liens senior to that of the lender. As illustrated in the examples in the question and answer, a junior lienholder's failure to take such a step can leave that lienholder partially or even fully unprotected by the borrower's NFIP policy in the event of a flood loss.

The final question and answer provides that a junior lienholder should work with the borrower, senior lienholder, or both these parties, to determine how much flood insurance is needed to adequately cover the improved real estate collateral to the lesser of the total of the outstanding principal balances on the junior loan and any senior loans, the maximum available under the Act, or the insurable value of the structure. The junior lienholder should also ensure that the borrower adds the junior lienholder's name as mortgagee/loss payee to an existing flood insurance policy.

The final question and answer also provides that a junior lienholder should obtain the borrower's consent in the loan agreement or otherwise for the junior lienholder to obtain information on balance and existing flood insurance coverage on senior lien loans from the senior lienholder. Commenters also contended that privacy concerns make it difficult for junior lienholders to obtain information from servicers or lenders about loan balances and existing flood insurance coverage. However, the Agencies have determined that the privacy provisions of the Gramm-Leach-Bliley Act, as implemented in the Agencies' regulations, do not prohibit sharing of the loan and flood insurance information between two lenders with liens on the same property, even without the borrower's consent.

One commenter noted that it is sometimes difficult to obtain information about the outstanding principal balance of other liens once a loan has been closed, such as at loan renewal, and asked what steps might be taken in that regard. The final question and answer states that junior lienholders have the option of obtaining a borrower's credit report to establish the outstanding balances of senior liens on property to aid in determining how much flood insurance is necessary upon increasing, extending or renewing a junior lien.

In the limited situation where a junior lienholder or its servicer is unable to obtain the necessary information about the amount of flood insurance in place on the outstanding balance of a senior lien (for example, in the context of a loan renewal), the final question and answer provides that the junior lienholder may presume that the amount of insurance coverage relating to the senior lien in place at the time the junior lien was first established (provided that the amount of flood insurance coverage relating to the senior lien was adequate at the time) continues to be sufficient.

The Agencies have revised the proposed question and answer to respond to these comments. The question and answer also provides examples illustrating the application of these methods of dealing with adequate flood insurance coverage for junior and senior liens. Specifically, the examples illustrate how a junior lienholder should handle situations such as: when a senior lienholder has obtained an inadequate amount of flood insurance coverage, when a senior lienholder is not subject to the Act's and Regulation's requirements; and when insurance coverage in the amount of the improved real estate's insurable value must be obtained by the junior lienholder.

Commenters also raised other issues related to ongoing flood insurance coverage on existing second lien loans in the context of force placement. The final question and answer addresses the triggering events of making, increasing, extending, and renewing a second lien loan.

Proposed question and answer 33 (final question and answer 37) addressed flood insurance requirements in connection with home equity loans secured by junior liens. Ten commenters requested that the question and answer be clarified to address other subordinate lien loans, not just junior lien home equity loans. The Agencies agree with the commenters and, therefore, have revised the question and answer to clarify that it applies to all subordinate lien loans.

Another commenter recommended that the ''same lender'' exception also apply to a lender's affiliates. The Act provides that a person who increases, extends, renews, or purchases a loan secured by improved real estate or a mobile home may rely on a previous determination of whether the building or mobile home is located in an area having special flood hazards, if the previous determination was made no more than seven years before the date of the transaction and there have been no subsequent map revisions. 42 U.S.C. 4104b(e). The Act further defines the term ''person'' to include any individual or group of individuals, corporation, partnership, association, or any other organized group of persons, including State and local governments and agencies thereof. 42 U.S.C. 4121(a)(5). The Agencies do not interpret the definition as providing for the inclusion of affiliates within a corporate entity as constituting a single ''person'' except for treating a regulated lending institution and its operating subsidiaries as a single entity. The Agencies believe that no further revision of the question and answer is appropriate on this point. The Agencies adopt the question and answer as proposed subject to the revisions discussed above.

Proposed question and answer 34 (final question and answer 38) addressed the issue of whether a loan secured by inventory stored in a building located in an SFHA, when the building is not collateral for the loan, requires flood insurance. One commenter asked what sort of legal instrument would have to be filed by a lender to result in the need for flood insurance coverage for a borrower's contents. The Agencies decline to respond to this inquiry because it involves a business and legal decision beyond the interpretation of the Act and Regulation. The Agencies adopt the question and answer as proposed.

Proposed question and answer 35 (final question and answer 39) addressed flood insurance requirements when building contents are security for a loan. Seven commenters requested further guidance and clarification on how to calculate flood insurance contents coverage in compliance with Federal regulation. Five commenters specifically requested that the Agencies give examples to illustrate how flood insurance coverage works for building and contents. Two commenters asked whether a lender should consider the total amount of coverage for both contents and building together or should consider the two separately. One commenter asked whether a lender could do the same with contents and building coverage as is the practice with coverage for multiple buildings, that is, the contents and building will be considered to have a sufficient amount of flood insurance coverage for regulatory purposes as long as some amount of insurance is allocated to each category.

The Agencies agree that the practice for flood insurance coverage for multiple buildings would also be applicable to coverage for both contents and building. That is, both contents and building will be considered to have a sufficient amount of flood insurance coverage for regulatory purposes as long as some reasonable amount of insurance

Copyright © 2009 Association of Corporate Counsel

Federal Register / Vol. 74, No. 138 / Tuesday, July 21, 2009 / Notices 35925

is allocated to each category. The Agencies have added an example to this question and answer to illustrate this point. The Agencies otherwise adopt the question and answer as proposed.

Proposed question and answer 36 (final question and answer 40), addressed the flood insurance requirements applicable to collateral or contents that do not secure a loan. The Agencies did not receive any substantive comments and adopt it as proposed.

Proposed question and answer 37 (final question and answer 41) addressed the Regulation's application where a lender places a lien on property out of an ''abundance of caution.'' One commenter recommended that flood insurance coverage should not be required when an interest is taken by a lender in improved real estate in a flood hazard zone out of an ''abundance of caution.''

The Agencies decline to accept this recommendation. The Act provides that a lender may not make, increase, extend, or renew any loan secured by improved real estate or a mobile home in a flood hazard area unless the building or mobile home is covered for the term of the loan by flood insurance. 40 U.S.C. 4012a(b)(1). The statute makes no exception for property taken as collateral by a lender out of an abundance of caution. The Agencies adopt the question and answer as proposed.

Proposed question and answer 38 (final question and answer 42) addressed loans secured by a note on a single-family dwelling, but not the dwelling itself. Proposed question and answer 39 (final question and answer 43) pertained to loans personally guaranteed by a third party who gave the lender a security interest in improved real estate owned by the guarantor. One commenter stated that the two proposed questions and answers conflicted. The Agencies do not believe there is a conflict between the two questions and answers. In the former question and answer, the Agencies concluded that Federal flood insurance requirements did not apply because the loan was not secured by improved real estate, but was instead secured by a note. In the latter question and answer, the lender was given a security interest in improved real estate by a third party in connection with the third party providing a personal guarantee on a loan. In each situation, the absence or presence of a security interest in improved real estate determined whether Federal flood insurance requirements would apply. The Agencies believe that no further elaboration is necessary and adopt these questions and answers as proposed.

Section VIII. Flood Insurance Requirements in the Event of the Sale or Transfer of a Designated Loan and/or Its Servicing Rights

Proposed Section IX (final Section VIII) addressed flood insurance requirements in the event of the sale or transfer of a designated loan and/or its servicing rights. This section and the accompanying questions and answers were originally adopted in the 1997 Interagency Questions and Answers, and any changes proposed by the Agencies in the March 2008 Proposal were designed to provide greater clarity with no intended change in substance and meaning. The comments received by the Agencies regarding the questions and answers in this section were generally supportive.

Proposed question and answer 41 (final question and answer 44) addressed the application of the flood insurance requirements under the Regulation to lenders/loan servicers under different scenarios. Upon consideration of the various comments, the Agencies have clarified the question and answer to apply to both regulated and nonregulated lenders. One commenter was supportive of the guidance, but recommended that lenders be allowed to assign a certain level of responsibility for flood insurance compliance through contractual arrangements to the servicer. The commenter asserted that this approach would not absolve lenders of liability and ultimate responsibility, but would make for a less burdensome and logical approach. The Agencies believe that the lender's responsibilities are sufficiently clear in the question and answer and that further elaboration on this point is unnecessary.

Another commenter asked that the Agencies expressly indicate that no servicing obligations need be followed by a lender who has sold both the loan and the servicing rights to a nonregulated party. The Agencies have elected to clarify in the answer that once the regulated lender has sold the loan and the servicing rights, the lender has no further obligation regarding flood insurance on the loan. The Agencies have also elected to clarify in the answer that, depending upon the circumstances, safety and soundness considerations may sometimes necessitate that the lender undertake sufficient due diligence upon purchase of a loan as to put the lender on notice of lack of adequate flood insurance. Moreover, if the purchasing lender subsequently extends, increases, or renews a designated loan, it must also comply with the Act and Regulation. The Agencies otherwise adopt the question and answer as proposed.

Proposed question and answer 42 (final question and answer 45), addressed when a lender is required to notify FEMA or the Director's designee. Proposed question and answer 43 (final question and answer 46), addressed whether a RESPA Notice of Transfer sent to the Director of FEMA satisfies the Act and Regulation. The Agencies received one comment that was supportive of these proposed questions and answers. The Agencies adopt the questions and answers as proposed.

Proposed question and answer 44 (final question and answer 47), indicated that delivery of the notice can be made electronically, including by batch transmission if acceptable to the Director or the Director's designee. The Agencies did not receive any substantive comments and adopt this question and answer as proposed.

Proposed question and answer 45 (final question and answer 48) indicated that if a loan and its servicing rights are sold by the lender, the lender is required to provide notice to the FEMA Director or the Director's designee. The Agencies received one comment that was supportive of the proposed question and answer. The Agencies adopt the question and answer as proposed.

Proposed question and answer 46 (final question and answer 49), indicated that a lender is not required to provide notice when the servicer, not the lender, sells or transfers the servicing rights to another servicer; rather the servicer is obligated to provide the notice. Proposed question and answer 47 (final question and answer 50) indicated that in the event one institution is acquired by or merges with another institution, the duty to provide the notice for loans being serviced by the acquired institution falls to the successor institution if notification is not provided by the acquired institution prior to the effective date of the acquisition or merger. The Agencies received one comment that was supportive of these proposed questions and answers. The Agencies adopt the questions and answers as proposed.

Section IX. Escrow Requirements

Proposed Section X (final Section IX) addressed escrow requirements for flood insurance premiums. This section and the accompanying questions and answers were originally adopted in the 1997 Interagency Questions and Answers, and any changes proposed by the Agencies were designed to provide

Copyright © 2009 Association of Corporate Counsel

greater clarity with no intended change in substance and meaning. The Agencies received few comments on this section.

Proposed question and answer 48 (final question and answer 51), addressed when multifamily buildings and mixed-use properties are considered residential real estate. A financial institution commenter requested two clarifications. First, the commenter noted that the proposed answer indicated that lenders are required to escrow flood insurance premiums and fees for any mandatory flood insurance for designated loans if the lender requires the escrow of taxes, hazard insurance premiums, ''or other loan charges'' for loans secured by residential improved real estate. The commenter questioned whether lenders are required to escrow flood insurance premiums and fees for any mandatory flood insurance for designated loans if the lender requires the escrow of mortgage insurance premiums. The Agencies believe that escrowing flood insurance premiums and fees for mandatory flood insurance for designated loans is required by the Act and Regulation where the lender requires the escrowing of mortgage insurance premiums. The Act and Regulation require escrowing if a regulated lending institution requires the escrowing of ''taxes, insurance premiums, fees, or any other charges.'' Mortgage insurance is a form of insurance. It is also an ''other charge'' under the Regulation. To provide greater consistency with the Act and Regulation, the Agencies are inserting the word ''any'' into the answer so that it refers to taxes, insurance premiums, fees, ''or any other charges.''

The commenter also asked the Agencies to expressly state in the answer that a lender is not required to escrow flood insurance premiums if it chooses to make an exception on a loan-by-loan basis not to escrow other items such as taxes, hazard insurance premiums, or other loan charges. In response, the Agencies have added a sentence to the answer providing that a lender is not required to escrow flood insurance premiums and fees for a particular loan if it does not require escrowing of any other charges for that loan.

Finally, because the Agencies are adopting questions and answers providing examples of residential and nonresidential properties, the discussion of mixed-use properties has been revised to refer the reader to those questions and answers. If the primary use of a mixed-use property is for residential purposes, the Regulation's escrow requirements apply. The Agencies otherwise adopt the question and answer as proposed.

Proposed question and answer 49 (final question and answer 52) addressed when escrow accounts must be established for flood insurance purposes and indicated that escrow accounts should look to the definition of ''Federally related mortgage loan'' contained in the Real Estate Settlement Procedures Act (RESPA) to see whether a particular loan is subject to RESPA's escrow requirements. The Agencies did not receive any substantive comments on the proposed question and answer; however, the Agencies made nonsubstantive revisions to the answer to more directly respond to the question asked and to provide additional clarity.

The Agencies received no comments on proposed questions and answers 50 and 51 (final questions and answers 53 and 54 respectively). Proposed question and answer 50 (final question and answer 53) indicated that voluntary escrow accounts established at the request of the borrower do not trigger a requirement for the lender to escrow premiums for required flood insurance. Proposed question and answer 51 (final question and answer 54) indicated that premiums paid for credit life insurance, disability insurance, or similar insurance programs should not be viewed as escrow accounts requiring the escrowing of flood insurance premiums. The Agencies did not receive any substantive comments on these questions and answers and adopt them as proposed.

Proposed question and answer 52 (final question and answer 55) advised that only certain escrow-type accounts for commercial loans secured by multifamily residential buildings trigger the escrow requirement for flood insurance premiums. The Agencies did not receive any substantive comments and adopt this question and answer as proposed.

Proposed question and answer 53 (final question and answer 56) addressed escrow requirements for condominium units covered by RCBAPs. The Agencies received several comments on this question and answer. Two financial institution commenters reiterated their comments pertaining to proposed question and answer 24 (final question and answer 28) that lenders or servicers of a loan to a condominium unit owner do not receive a copy of the RCBAP renewal information because they are not loss payees on the policy. This comment was addressed in the SUPPLEMENTARY INFORMATION pertaining to Section VI above. A financial institution requested clarification that regardless of whether the lender makes a loan for the purchase or refinance of a condominium unit, an escrow account is not required if dues to the condominium association apply to the RCBAP premiums. The proposed question and answer only addressed purchase loans; however, the Agencies agree with the commenter that the same principle should apply to refinancings. The Agencies, therefore, are clarifying the question and answer to provide that when a lender makes, increases, renews, or extends a loan secured by condominium unit that is adequately covered by an RCBAP, and dues to the condominium association apply to the RCBAP premiums, an escrow account is not required. However, if the RCBAP coverage is inadequate and the unit is also covered by a dwelling form policy, premiums for the dwelling form policy would need to be escrowed. The Agencies otherwise adopt the question and answer as proposed.

X. Force Placement of Flood Insurance

Proposed Section XI (final Section X) addressed issues concerning the force placement of flood insurance. This section and the accompanying questions and answers were originally adopted in the 1997 Interagency Questions and Answers and any changes proposed by the Agencies in March 2008 were designed to provide greater clarity with no intended change in substance and meaning.

The Agencies received several comments on proposed question and answer 54 (final question and answer 57), which provided general guidance on the force placement requirement under the Act and Regulation. Six commenters requested further guidance regarding the exact point at which lenders must commence the force placement process. Similarly, commenters requested clarification as to precisely when the 45-day notice period begins after which a lender or its servicer must force place insurance. One of these commenters specifically asked the Agencies to clarify whether insurance is required 45 days from the date the institution received the cancellation notice, the date of cancellation on that notice, or the date that the borrower receives notice from the lender or servicer. One commenter requested clarification from the Agencies whether the 45-day notice could be sent prior to the actual date of expiration of flood insurance coverage.

As discussed in the proposed question and answer, the Act and Regulation require the lender, or its servicer, to send notice to the borrower upon making a determination that the

Copyright © 2009 Association of Corporate Counsel

Federal Register / Vol. 74, No. 138 / Tuesday, July 21, 2009 / Notices 35927

improved real estate collateral's insurance coverage has expired or is less than the amount required for that particular property, such as upon receipt of the notice of cancellation or expiration from the insurance provider. The notice to the borrower must also state that if the borrower does not obtain the insurance within the 45-day period, the lender will purchase the insurance on behalf of the borrower and may charge the borrower for the cost of premiums and fees to obtain the coverage. The Act does not permit a lender or its servicer to send the required 45-day notice to the borrower prior to the institution's making a determination that flood insurance is insufficient or lacking (for example, the actual expiration date of the flood insurance policy). If adequate insurance is not obtained by the borrower within the 45-day period, then the insurance must be obtained by the lender on behalf of the borrower.

Another commenter stated that if a lender decides to pay a borrower's current policy premium, this should not be considered to be purchasing a force placed policy. The Agencies agree that it is within a lender's discretion to absorb the costs of a borrower's flood insurance policy anytime during the term of the designated loan. This should not, however, eliminate the borrower's opportunity to obtain appropriate flood insurance coverage, especially during the 45-day period after receiving a force placement notice from the lender. The Agencies revised proposed question and answer 54 (final question and answer 57) to address these commenters' points.

The Agencies also received questions from commenters regarding coverage during the 45-day notice period. Two commenters asked how to ensure that collateral property is protected against flood damage during the 45-day notice period prior to actual force placement. Another commenter asked for more explanation about the coverage that continues in effect for 30 days after the date that a Standard Flood Insurance Policy (SFIP) expires under the NFIP.

Coverage under FEMA's SFIP continues in effect for 30 days from the date that the SFIP lapses. An SFIP specifically provides that, if the insurer decides to cancel or not renew a policy, it will continue in effect for the benefit of only the mortgagee for 30 days after the insurer notifies the mortgagee of the cancellation or nonrenewal. No coverage will be provided for a borrower under the SFIP during this 30-day period. If a lender monitors a mortgage loan with respect to the need for flood insurance coverage, the lender can time the 45-day period to start with the lapse of insurance coverage. Assuming notification is made immediately upon policy cancellation or nonrenewal, coverage will continue in place for the lender/mortgagee's benefit for 30 days of the 45-day notice period. To cover the risk during the remaining 15-day "gap," lenders may purchase private flood insurance to cover the collateral property, as discussed further in section XI below regarding private insurance policies. Lenders in these situations, often purchase what is known in the insurance industry as a "30-day binder," a form of temporary private insurance. The insurance provided by such a binder will cover the 15-day gap and the 15 days subsequent to the end of the notice period. Because these issues lie outside the scope of the Agencies' purview, however, the Agencies decline to include this guidance in the question and answer.

One commenter contended that one of the criteria for force placement in proposed question and answer 54 (final question and answer 57) should be changed from "[t]he community in which the property is located participates in the NFIP" to "flood insurance under the Act is available for improved property securing the loan," because properties may also be in Coastal Barrier Resource Areas, Otherwise Protected Areas, or areas designated under section 1316 of the Flood Act. The Agencies have revised final question and answer 57 to reflect this requested change. Another commenter asked whether the citation to "Appendix A of the FEMA publication" in proposed question and answer 54 was a reference to the immediately previously cited FEMA procedures that were published in the **Federal Register**. The Agencies have revised final question and answer 57 to clarify the citation.

Proposed question and answer 55 (final question and answer 58), addressed whether a servicer can force place insurance on behalf of a lender. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

Proposed question and answer 56 (final question and answer 59) addressed the amount of insurance required when force placement occurs. The Agencies received one comment suggesting that the proposed answer to proposed question 56 not only cross-reference Section II of the Interagency Questions and Answers, but also refer to Section VII, because proposed question and answer 36 in that section pertains to the required amount of flood insurance for home equity loans. The Agencies have made minor clarifications based upon this comment, but otherwise adopt the question and answer as proposed.

The Agencies received comments regarding terminology used in this section. Specifically, two commenters took exception to the use of the term "force placement," arguing that the term conveys an incorrect impression that the borrower is being forced to accept the purchase of flood insurance coverage when the reverse of the situation applies. These commenters suggested that the alternative term "lender placed" should be used instead. The current term "force placement" is used in the Regulation. Moreover, the term has been widely used since the enactment of the National Flood Insurance Reform Act of 1994. Changing the term may cause confusion. For this reason, the Agencies decline to accept this suggested change.

Another commenter recommended that "lender single interest policies" should not be allowed and should be considered in violation of the legal requirements of the Act and Regulation since they are not purchased on the borrower's behalf and do not offer the same or better policy terms to the borrower. As discussed in further detail in the discussion to section XI below, private insurance policies may only be considered an adequate substitute for an SFIP if the policy meets the criteria set forth by FEMA, including the requirement that the coverage be as broad as an SFIP. The Agencies have declined to address this comment specifically because it is believed that the comment is addressed by the general guidance in section XI.

In response to comments received regarding the force placement of flood insurance, the Agencies are proposing three new questions and answers (60, 61, and 62), which are discussed in the **SUPPLEMENTARY INFORMATION** immediately following the Redesignation Table, to be added to Section VII to address the following force-placement issues: when the 45-day notice period should begin, how soon a lender should take action after learning that improved real estate that secures a loan is uninsured or underinsured, and whether a borrower may be charged for the cost of flood insurance coverage during the 45-day notice period.

XI. Private Insurance Policies

Proposed Section XII (final Section XI) addressed the appropriateness of gap or blanket insurance policies, often purchased by lenders to ensure adequate life-of-loan flood insurance coverage for designated loans. The proposed answer to question 57 (final

35928 Federal Register / Vol. 74, No. 138 / Tuesday, July 21, 2009 / Notices

question and answer 63) explained, generally, that gap or blanket insurance is not an adequate substitute for NFIP insurance. The proposed answer, however, did acknowledge that in limited circumstances, a gap or blanket policy may satisfy flood insurance obligations in instances where NFIP and private insurance for the borrower are otherwise unavailable.

The Agencies received several comments regarding the proposed question and answer. Some industry commenters argued that gap or blanket insurance is a cost-effective alternative to NFIP insurance and should be permitted as a substitute for NFIP insurance in all cases. Other industry commenters argued that gap or blanket insurance should be permitted as a substitute for NFIP insurance under certain circumstances, such as for construction loans or underinsured properties. Still other industry commenters asked the Agencies to clarify the use of the terms ''gap'' and ''blanket'' policies, noting that the common industry understanding is that ''gap'' policies are distinguishable from ''blanket'' policies. In particular, these commenters requested that the Agencies eliminate the prohibition on ''gap'' policies that are meant to cover the deficiency between a borrower's coverage and the amount of insurance required under the Act and Regulation. One industry commenter also noted that there are different types of ''gap'' policies and suggested that the Agencies clarify its intentions to prohibit only certain types of ''gap'' policies. Lastly, commenters also requested general guidance on whether non-NFIP private insurance policies were permitted.

Based on these comments, the Agencies have decided to modify the question and answer to address broader issues of the appropriateness of private insurance. Instead of focusing on whether a policy is called a ''gap'' insurance policy or a ''blanket'' insurance policy, which may depend on how the policy is marketed by the insurer, the Agencies have decided that it is more appropriate to provide guidance to lenders on private insurance policies in general.

The Agencies have revised the answer to the question to provide that a private insurance policy may be an adequate substitute for an NFIP policy if it meets the criteria set forth by FEMA in its *Mandatory Purchase of Flood Insurance Guidelines.*[8] As FEMA has stated in its *Mandatory Purchase of Flood Insurance Guidelines,* to the extent there are any differences between the private insurance policy and an NFIP Standard Flood Insurance Policy, those differences must be evaluated carefully by the lender to determine whether the policy would provide sufficient protection under the Act and Regulation. Lenders must consider the suitability of a private insurance policy only when the mandatory purchase requirements apply. Therefore, if the Act or Regulation does not require the purchase of flood insurance, the lender need not evaluate the policy to determine whether it meets the criteria set forth by FEMA.

The guidance proposed in March 2008 on the limited circumstances when gap or blanket policies are permissible has been revised and is being addressed in a new separate question and answer 64. The answer to final question 64 provides that in the event that a flood insurance policy has expired and the borrower has failed to renew coverage, a private insurance policy that does not meet the criteria set forth by FEMA may nevertheless be useful in protecting the lender during a gap in coverage in the period of time before a force placed policy takes effect. However, the answer further states that the lender must force place NFIP-equivalent coverage in a timely manner and may not rely on non-equivalent coverage on an on-going basis. This is consistent with guidance proposed in March 2008, though the language has been modified in response to commenters who thought this guidance was confusing as worded in the proposal.

Section XII. Required Use of the Standard Flood Hazard Determination Form (SFHDF)

Proposed Section XIII (final Section XII) addressed the required use of the Special Flood Hazard Determination Form (SFHDF). This section and the accompanying questions and answers were originally adopted in the 1997 Interagency Questions and Answers. The changes proposed by the Agencies in March 2008 were designed to provide greater clarity with no intended change in substance and meaning. The agencies received a number of comments on this section.

Proposed question and answer 58 (final question and answer 65), addressed whether the SFHDF replaces the borrower notification form. One commenter suggested the answer clarify the SFHDF's use to the lender and the notification form's use to benefit the borrower. The Agencies agree with the commenter and have revised the proposed answer to be more responsive to the question and to more clearly set out the respective uses of the SFHDF and the borrower notification form. Information about the notice of special flood hazards may be found in section XV. The commenter also suggested that the Agencies should amend the proposed answer to provide that the SFHDF must be used by the lender to determine if the ''improved'' property securing the loan is located in an SFHA. The Regulation specifically provides that a lender must make a flood hazard determination and use the SFHDF when determining whether the ''building or mobile home offered as collateral security for a loan is or will be located in an SFHA in which flood insurance is available under the Act.'' The Agencies agree that it is appropriate to revise the proposed question and answer to conform to the language of the Regulation and have done so.

Proposed question and answer 59 (final question and answer 66), addressed whether a lender is required to provide a copy of the SFHDF to the applicant/borrower. The Agencies received two comments concerning the proposed question and answer. The commenters suggested that the answer should state that the Act does not require that the lender provide the borrower with a copy of the SFHDF. The Agencies have revised the proposed question and answer to note that, while not a statutory requirement, a lender may provide a copy of the flood determination to the borrower so the borrower can provide it to the insurance agent in order to minimize flood zone discrepancies between the lender's determination and the borrower's policy. A lender would also need to make the determination available to the borrower in case of a special flood hazard determination review, which must be requested jointly by the lender and the borrower. In the event a lender provides the SFHDF to the borrower, the signature of the borrower is not required to acknowledge receipt of the form.

Proposed question and answer 60 (final question and answer 67) addressed the use of the SFHDF in electronic format. The Agencies did not receive any substantive comment and adopt the question and answer as proposed.

Proposed question and answer 61 (final question and answer 68) addressed the circumstances when a lender may rely on a previous special flood hazard determination. The Agencies received several comments concerning this question and answer. One commenter suggested that, if a lender maintains life-of-loan tracking, there is little benefit in obtaining a new special flood hazard determination

[8] FEMA, Mandatory Purchase of Flood Insurance Guidelines, at 57–58.

Copyright © 2009 Association of Corporate Counsel

when renewing, refinancing, or extending a loan if the original determination is older than seven years. The authority to rely on a previous determination made within the previous seven years if that determination meets certain requirements is statutory (42 U.S.C. 4104b(e)). Accordingly, seven years is the maximum period during which a lender may rely on a previous determination, even if the lender has maintained life-of-loan tracking.

Two commenters suggested that the proposed question and answer should also address whether a lender may rely on one determination if a lender makes multiple loans to one borrower, all of which are secured by the same improved property. For example, it should address when a lender may rely on a single determination when making a home purchase loan and a subsequent home equity loan, both secured by the same residence. The situation described by the commenters is similar to the example of a refinancing or assumption by a lender, which obtained the original flood determination on the same security property. In that case, the question and answer states that the lender may rely on the original determination if the original determination was made not more than seven years before the date of the transaction, the basis of the determination was set forth on the SFHDF, and there were no map revisions or updates affecting the security property since the original determination was made. The Agencies based this interpretation on the premise that a refinancing would be the functional equivalent of either a loan extension or renewal. Subsequent loans to the same borrower secured by the same improved real estate could be deemed to be the functional equivalent of increasing the amount of the original loan. Therefore, if the original determination was made not more than seven years before the date of the transaction, the basis of the determination was set forth on the SFHDF, and there were no map revisions or updates affecting the security property since the original determination was made, a lender may similarly rely on a previous determination if the lender makes multiple loans that are secured by the same building or mobile home. The Agencies have revised the proposed question and answer to also address subsequent loans by the same lender secured by the same improved real estate.

Section XIII. Flood Determination Fees

Proposed Section XIV (final Section XIII) consisted of proposed questions and answers 62 and 63 (final questions and answers 69 and 70 respectively), which addressed fees charged when making a flood determination and charging fees to cover life-of-loan monitoring of a loan, respectively. The Agencies received two comments on these questions and answers. One commenter supported them; the other commenter asked whether a lender could charge an up-front, nonrefundable, composite determination and life-of-loan fee regardless of whether the loan application closes. The Act and Regulation allow a lender to charge a reasonable fee for determining whether a building or mobile home securing a loan is located or will be located in a special flood hazard area if the determination is made in connection with the making, increasing, extending, or renewing of a loan that is initiated by the borrower. In the commenter's situation, the Agencies would agree that a fee for an initial determination could be charged when the determination is procured in connection with an application initiated by an applicant, even if the application does not close. However, a lender cannot charge a life-of-loan fee if the application does not close. Such a fee would be an unearned fee and, as such, charging such a fee would be prohibited by section 8 of RESPA. Therefore, a lender may not charge a nonrefundable, composite determination and life-of-loan fee when a loan application does not close. The Agencies have adopted the former question and answer as proposed. The Agencies have revised the latter question and answer in response to the comment.

Section XIV. Flood Zone Discrepancies

Proposed Section XV (final Section XIV) addressed flood zone discrepancies between the flood hazard designation documented by the lender on the SFHDF and the one documented on the flood insurance policy and used to rate the policy. There were numerous negative comments concerning the Agencies' proposed guidance for dealing with such discrepancies.

Proposed question and answer 64 (final question and answer 71) addressed lenders' recourse when confronted with a flood zone discrepancy. Nineteen commenters were generally opposed to the proposed treatment of a discrepancy as set forth in the proposed question and answer. Several of these commenters argued that the Act does not require lenders to identify and resolve flood zone discrepancies and ensure that a flood insurance policy is properly rated. Other commenters argued that it is an undue burden to expect financial institutions to resolve discrepancies between the SFHDF and the flood insurance policy. Six commenters maintained that it is an insurance agent's responsibility to determine the correct flood zone and that a lender should not be responsible for auditing an NFIP-authorized insurance agent. These commenters argued that requiring lenders to document every flood zone discrepancy would be costly and burdensome and require extensive loan servicing system changes.

Two commenters stated that the Agencies need to clearly define ''zone discrepancy.'' Another commenter asked what action would be required to correct any ''violation'' and further inquired how much flood insurance should be force placed in such a situation if a lender wants to correct a discrepancy by means of force placement. Two other commenters said that a borrower will not want to obtain a Letter of Determination Review from FEMA at a cost of $80 when there is a dispute between the lender and insurance company over a flood zone discrepancy, while three other commenters noted that it is unreasonable to expect the parties to wait 45 days for a FEMA determination review. Finally, two commenters noted that if a coverage error occurs, the borrower or lender may reconcile this through payment of the premium differential (the amount of premium that would have been charged if the policy had been correctly rated) or FEMA may reduce the amount of claim payment.

The Agencies disagree with those commenters who argued against a lender being responsible for resolving flood zone designation discrepancies, either as a legal matter or because the requirement would be burdensome and costly. The Agencies agree, and FEMA concurs, that Federal law places the ultimate responsibility to ensure appropriate flood insurance coverage on the lender. The Agencies note that, although coverage errors can be mitigated after a flood loss by paying premium differentials or reducing the claim payment, these mitigation techniques do not relieve a lender of the responsibility to ensure that an appropriate amount of flood insurance coverage is in place when a loan is made.

Commenters, however, raised valid points with respect to the proposed process for resolving flood zone

discrepancies. To address these points, the Agencies have revised final question and answer 71 to specify that lenders need only address discrepancies between high-risk zones (Zones A or V) and moderate- or low-risk zones (Zones B, C, D, or X). The revised question and answer further specifies the actions a lender should take if such a zone discrepancy is found to exist. Those steps continue to include attempting to determine whether the discrepancy is a result of a legitimate reason, such as grandfathering, or is a mistake. In certain circumstances, submitting a request for a Determination Review to FEMA may be an appropriate means of resolving discrepancies; however, it is not required in all situations. The question and answer explains that if the discrepancy is not resolved, the lender should send a letter to the insurance agent and/or the insurance company reminding them of FEMA's April 16, 2008, instruction that, in cases of determination discrepancies, the policy should be written to cover the higher risk zone. Beyond that, no further action by the lender is required. If, for its own purposes, the lender believes force placement is appropriate, then it should consult the guidance on that topic found in Sections II and X.

Proposed question and answer 65 (final question and answer 72), addressed whether lenders can be found in violation of the Act and Regulation for flood zone discrepancies. Seven commenters either registered their opposition to the proposed question and answer or recommended that it be deleted outright. These commenters argued, similar to their comments on proposed question and answer 64, that the lender is the wrong person to resolve flood zone discrepancies, that it is instead the responsibility of the insurance agent and the company issuing the flood insurance policy to ensure that the flood zone is correct, and that imposing this requirement on lenders is an unnecessary burden not mandated by law. Another commenter argued that by sanctioning lenders for not successfully identifying and resolving flood zone discrepancies, the two proposed questions and answers would create a duty to ensure that the flood policy is rated properly that does not presently exist under the Act or the Regulation.

As noted above, the Act and the Regulation require lenders to ensure that an appropriate amount of flood insurance coverage is purchased; lenders, therefore, should take steps to identify and address flood zone discrepancies. If a pattern or practice of unresolved discrepancies is found in a lender's loan portfolio, due to a lack of effort on the lender's part to resolve such discrepancies using the process outlined in final question and answer 71, the Agencies may cite the lender for a violation of the mandatory purchase requirements.

Section XV. Notice of Special Flood Hazards and Availability of Federal Disaster Relief

Proposed Section XVI (final Section XV) addressed the notice of special flood hazards and the availability of Federal disaster relief that lenders are generally required to provide to borrowers. The proposed questions and answers primarily proposed only minor wording changes or clarifications to questions and answers in the 1997 Interagency Questions and Answers without any change in the substance or meaning.

Proposed question and answer 66 (final question and answer 73), addressed whether the notice had to be provided to each borrower for each real estate related loan. The proposed answer explained that in a transaction involving multiple borrowers, the lender is only required to send notice to one borrower, but may provide multiple notices if the lender chooses. The Agencies received a comment on a related issue asking who should receive the notice if, at the time of increase, real estate collateral has been hypothecated by a guarantor as security on the borrower's loan. If a lender takes a security interest in improved real estate owned by a guarantor (not simply pledged by a guarantor) located in an SFHA, then flood insurance is required and the notice should be sent to both the borrower and the guarantor.

Another commenter asked when borrowers have to be notified that their secured property is in a flood zone. The commenter noted that their examiners have previously said ten days prior to loan closing. As noted in the Regulation, lenders are required to provide notice within a reasonable time before completion of the transaction (loan closing). What constitutes ''reasonable'' notice will necessarily vary according to the circumstances of particular transactions. Regulated lending institutions should bear in mind, however, that a borrower should receive notice timely enough to ensure that (1) the borrower has the opportunity to become aware of the borrower's responsibilities under the NFIP; and (2) where applicable, the borrower can purchase flood insurance before completion of the loan transaction. In light of these considerations, the final question and answer does not establish a fixed time period during which a lender must provide the notice to the borrower. The Agencies generally continue to regard ten days as a ''reasonable'' time interval. The Agencies adopt the question and answer as proposed.

Proposed question and answer 67 (final question and answer 74) addressed how the notice requirement applied to loans secured by mobile homes where the location of the mobile home may not be known until just prior to, or sometimes after, the loan closing. The Agencies did not receive any substantive comments and adopt the question and answer as proposed.

Proposed question and answer 68 (final question and answer 75), addressed when the lender is required to provide notice to the loan servicer that flood insurance is required. Proposed question and answer 69 (final question and answer 76) addressed what constitutes appropriate notice to the loan servicer. Proposed question and answer 70 (final question and answer 77) addressed whether it was necessary for the lender to provide notice to a loan servicer affiliated with the lender. Proposed question and answer 71 (final question and answer 78) addressed how long a lender has to maintain the record of receipt by the borrower of the notice. The Agencies received one comment that was supportive of these proposed questions and answers. The Agencies adopt the questions and answers as proposed.

Proposed question and answer 72 (final question and answer 79), addressed whether a lender can rely on a previous notice that is less than seven years old and was given to the same borrower for the same property by the same lender. Two commenters stated that lenders should be able to waive a notice to a borrower when they already have adequate flood insurance and one commenter said that notice should not be required when there has not been a change in the flood map. The Act and Regulation require lenders to send notice when a lender makes, increases, extends, or renews a loan secured by a building or a mobile home located or to be located in a special flood hazard area. Therefore, as a statutory requirement, the notice may not be waived. The Agencies adopt the question and answer as proposed.

Proposed question and answer 73 (final question and answer 80), addressed whether the use of the sample form of notice is mandatory. The Agencies received one comment that was supportive of the proposed question and answer; however, another commenter asked whether lenders

Copyright © 2009 Association of Corporate Counsel

Federal Register / Vol. 74, No. 138 / Tuesday, July 21, 2009 / Notices 35931

should use the revised version of the Sample Form of the Notice provided by FEMA in 2007 or the sample notice that accompanies the Regulation. The Agencies do not require the use of a specific form so long as the form contains the required information as specified by the Act and Regulation. The Agencies revised the answer, to reflect that the sample form of the notice provided by FEMA in its *Mandatory Purchase of Flood Insurance Guidelines* is also not required to be used.

Section XVI. Mandatory Civil Money Penalties

Proposed Section XVII (final Section XVI) addressed the imposition of mandatory civil money penalties for violations of the flood insurance requirements. Proposed question and answer 74 (final question and answer 81) listed the sections of the Act that trigger mandatory civil money penalties when examiners find a pattern or practice of violations of those sections and included information about statutory limits on the amount of such penalties. The Agencies did not receive any comments and adopt the question and answer as proposed.

Proposed question and answer 75 (final question and answer 82) addressed the general standards the Agencies consider when determining whether violations constitute a pattern or practice for which civil money penalties are mandatory. The Agencies received one industry trade group comment suggesting that proposed question and answer 75 be amended to clarify that the assessment of civil money penalties be based on an overall assessment of the entire loan portfolio and not randomly selected representations. The Agencies believe that the guidance in this question and answer properly sets forth the general standards the Agencies consider when determining whether a pattern or practice of violations has occurred. As discussed in the March 2008 Proposed Interagency Questions and Answers, the considerations listed in the proposed question and answer are not dispositive of individual cases, but serve as a reference point for reviewing the particular facts and circumstances. The Agencies adopt the question and answer as proposed.

Redesignation Table

The following redesignation table is provided as an aid to assist the public in reviewing the revisions to the 1997 Interagency Questions and Answers.

1997 Interagency questions and answers	Current questions and answers
Section I. Definitions	
Section I, Question 1	Section IV, Question 20.
Section I, Question 2	Section IV, Question 19.
Section I, Question 3	Section VII, Question 34.
Section I, Question 4	Section VII, Question 35.
Section I, Question 5	Section VII, Question 38.
Section I, Question 6	Section VII, Question 39; and Section VII, Question 40.
Section I, Question 7	Section VII, Question 41.
Section I, Question 8	Section VII, Question 42.
Section I, Question 9	Section I, Question 5.
Section I, Question 10	Section VII, Question 43.
Section II. Requirement to Purchase Flood Insurance Where Available.	
Section II, Question 1	Section I, Question 1.
Section II, Question 2	Section I, Question 3.
Section II, Question 3	Section I, Question 6.
Section II, Question 4	Deleted as obsolete.
Section II, Question 5	Section II, Question 15.
Section II, Question 6	Section VIII, Question 44.
Section II, Question 7	Section II, Question 14; and Section V, Question 25.
Section II, Question 8	Section VI, Question 28.
Section II, Question 9	Section VI, Question 31.
Section III. Exemptions.	Section III. Exemptions from the mandatory flood insurance requirements.
Section III, Question 1	Section III, Question 18.
Section IV. Escrow Requirements.	Section IX. Escrow requirements.
Section IV, Question 1	Deleted as obsolete.
Section IV, Question 2	Section IX, Question 51.
Section IV, Question 3	Section IX, Question 52.
Section IV, Question 4	Section IX, Question 53.
Section IV, Question 5	Section IX, Question 54.
Section IV, Question 6	Section IX, Question 55.
Section IV, Question 7	Section IX, Question 56.
Section V. Required Use of Standard Flood Hazard Determination Form (SFHDF).	Section XII. Required use of Standard Flood Hazard Determination Form (SFHDF).
Section V, Question 1	Section XII, Question 65.
Section V, Question 2	Section XII, Question 66.
Section V, Question 3	Section XII, Question 67.
Section V, Question 4	Section XII, Question 68.
Section V, Question 5	Section VII, Question 36; and Section VII, Question 37
Section VI. Force Placement of Flood Insurance.	Section X. Force placement of flood insurance.
Section VI, Question 1	Section X, Question 57.
Section VI, Question 2	Section X, Question 58.
Section VI, Question 3	Section X, Question 59.
Section VII. Determination Fees.	Section XIII. Flood determination fees.
Section VII Question 1	Section XIII, Question 69.
Section VII Question 2	Section XIII, Question 70.
Section VIII. Notice of Special Flood Hazards and Availability of Federal Disaster Relief.	Section XV. Notice of special flood hazards and availability of Federal disaster relief.
Section VIII, Question 1.	Section XV, Question 73
Section VIII, Question 2.	Section XV, Question 74.
Section VIII, Question 3.	Section XV, Question 75.
Section VIII, Question 4.	Section XV, Question 76.
Section VIII, Question 5.	Section XV, Question 77.
Section VIII, Question 6.	Section XV, Question 78.
Section IX. Notice of Servicer's Identity.	Section VIII. Flood insurance requirements in the event of the sale or transfer of a designated loan and/or its servicing rights.
Section IX, Question 1	Section VIII, Question 45.
Section IX, Question 2	Section VIII, Question 46.
Section IX, Question 3	Section VIII, Question 47.
Section IX, Question 4	Section VIII, Question 48.
Section IX, Question 5	Section VIII, Question 49.
Section IX, Question 6	Section VIII, Question 50.
Section X Appendix A to the Regulation—Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance.	Section XV. Notice of special flood hazards and availability of Federal disaster relief.
Section X, Question 1	Section XV, Question 80.

Proposed Questions and Answers and Request for Comment

The Agencies are proposing five new questions and answers for public

comment upon consideration of various comments received on the March 2008 Proposed Interagency Questions and Answers. The new proposed questions and answers concern the determination of insurable value in calculating the maximum limit of coverage available for the particular type of property under the Act and force placement of required flood insurance. In anticipation of the possible adoption of these proposed questions and answers, the applicable question and answer numbers have been reserved and the remaining questions and answers have been renumbered accordingly.

Insurable value. The Agencies received numerous comments to proposed question and answer 7 stating that implementing insurable value was confusing and that the term needed clear and objective standards. Commenters asked for guidance on the terms ''overall value'' and ''repair or replacement cost'' as they relate to a lender's determination of the required amount of flood insurance for a designated loan. Commenters similarly asked the Agencies to define the term ''actual cash value.'' In response to these comments, the Agencies are proposing new questions and answers 9 and 10 for public comment to address how to calculate insurable value. Calculating insurable value is important because in addition to the maximum caps under the Act, the Regulation provides that ''flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the property is located.'' The Agencies use the term ''insurable value'' in the proposed question and answer to mean the overall value minus the value of the land.

FEMA guidelines state that the full insurable value of a building is the same as 100 percent replacement cost value (RCV) of the insured building.[9] Replacement cost value, according to FEMA's *Mandatory Purchase of Flood Insurance Guidelines,* is the cost to replace property with the same kind of material and construction without deduction for depreciation.[10] As such, it is important to make clear that the RCV of a building is not its contributory value to the overall appraised value of the collateral and does not include any value for any land that is also part of collateral. When determining the RCV of a building, lenders (either by themselves or in consultation with the flood insurance provider or other professionals) should consider the replacement cost value under a hazard insurance policy, an appraisal based on a cost-value before depreciation deductions (not a market-value) approach, and/or a construction cost calculation.

The statutory and regulatory requirement that flood insurance be obtained in the amount of the lesser of the principal balance of the designated loan or the maximum limit of coverage available for the particular type of building under the Act is separate from the amount of a recovery if the improved property is destroyed by flood. Insurable value is replacement cost value and would be the amount required for adequate insurance coverage assuming that amount does not exceed the principal balance of the designated loan or the maximum limit of coverage under the Act. Actual cash value, which would be determined by a claims adjuster at the time of loss, is the amount that will be paid by the NFIP for nonresidential properties and certain residential properties. To lessen the effect of a potential difference between the two values with certain nonresidential buildings, the Agencies, with FEMA's concurrence, are proposing new questions and answers 9 and 10.

It is important for lenders to recognize that insurable value is only relevant to the extent that it is lower than either the outstanding principal balance of the loan or the maximum amount of insurance available under the NFIP. Therefore, if the insurable value of a building is the lesser of the outstanding principal balance of the loan or the maximum amount of insurance allowable under the NFIP, then the building must be insured at its insurable value, which for single family, 2–4 family, other residential or nonresidential buildings, is equivalent to its RCV. The Agencies are proposing new question and answer 9 to provide more concrete guidance on insurable value.

►*9. What is the insurable value of a building?*

Answer: Per FEMA guidelines, the insurable value of a building is the same as 100 percent replacement cost value of the insured building. FEMA's Mandatory Purchase of Flood Insurance Guidelines defines replacement cost as ''The cost to replace property with the same kind of material and construction without deduction for depreciation.'' When determining replacement cost value of a building, lenders (either by themselves or in consultation with the flood insurance provider or other professionals) should consider the replacement cost value used in a hazard insurance policy (recognizing that replacement cost for flood insurance will include the foundation), an appraisal based on a cost-value approach before depreciation deductions (not a market-value), and/or a construction cost calculation.◄

In considering the comments submitted on the subject of insurable value, the Agencies recognized that there are situations when insuring some nonresidential buildings at RCV would result in the building being over-insured. The Agencies, in consultation with FEMA, are proposing two alternatives to determine replacement cost value for nonresidential buildings used for ranching, farming, or industrial purposes, which the borrower either would not replace if damaged or destroyed by a flood or would replace with a structure more closely aligned to the function the building is providing at the time of the flood. Industrial use, as opposed to the broader commercial use, is defined as those buildings not directly engaged in the retail and/or wholesale sale of the business's goods, such as warehouses or storage, manufacturing, or maintenance facilities.

The first alternative is the ''functional building cost value,'' which is the cost to repair or replace a building with commonly used, less costly construction materials and methods that are functionally equivalent to obsolete, antique, or custom construction materials and methods used in the original construction of the building. Borrowers and/or lenders can choose this alternative when the building being insured is important to the business operation and would be replaced if damaged or destroyed by a flood, but not to its original condition. The ''functional building cost value'' recognizes that insurance to the replacement cost is not needed as the borrower would not repair or replace the building back to its original form but to a condition that represents the function the building is providing to the business operation.

The second alternative is the ''demolition/removal cost value,'' which is the cost to demolish the remaining structure and remove the debris after a flood. Borrowers and/or lenders can choose this alternative when the building being insured is not important to the business operation and would not be repaired or replaced if damaged or destroyed by a flood. The ''demolition/removal cost value'' recognizes that the building has limited-to-no-value and

[9] FEMA, Mandatory Purchase of Flood Insurance Guidelines, at 27.

[10] FEMA, Mandatory Purchase of Flood Insurance Guidelines, at GLS10.

Copyright © 2009 Association of Corporate Counsel

Federal Register / Vol. 74, No. 138 / Tuesday, July 21, 2009 / Notices 35933

that it does not provide an important enough function to necessitate that the business repair or replace it.

When a borrower or lender chooses one of these two replacement cost value alternatives they have determined that the building to be insured will not be insured to its full replacement cost value. Both the borrower and the lender should ensure that they consider the impact this may have on the ongoing nature of the business and the value of the collateral securing the loan. Full replacement cost is always the preferred insurance amount. These alternatives are available only for those situations where full replacement cost would result in a building used for farming, ranching, or industrial purposes being over-insured. The Agencies are proposing new question and answer 10 to address this issue.

►*10. Are there alternative approaches to determining the insurable value of a building?*

Answer: Yes, in the case of buildings used for ranching, farming, and industrial purposes, insurable value may also be determined by the functional building cost value or the demolition/removal cost value. The Agencies recognize that there are situations where insuring some nonresidential buildings to the replacement cost value will result in the building being over-insured. Therefore, borrowers and/or lenders have two alternative approaches to determine the insurable value for buildings used in ranching, farming, and for industrial purposes when the borrower would either not replace the building if damaged or destroyed by a flood or would replace the building with a structure more closely aligned with the function the building is presently providing. Industrial use, as opposed to the broader commercial use, means those buildings not directly engaged in the retail and/or wholesale sale of the business's goods, such as warehouses, storage, manufacturing, or maintenance facilities.

- The lender may calculate the insurable value as the ''functional building cost value,'' that is, the cost to replace a building with a lower-cost functional equivalent. The ''functional building cost value'' is the cost to repair or replace a building with commonly used, less costly construction materials and methods that are functionally equivalent to obsolete, antique, or custom construction materials and methods used in the original construction of the building. The determination of the appropriate ''functional building cost value'' amount of insurance should be made by the lender and/or borrower. This alternative may be chosen when the building is important to the ongoing nature of the business and would be replaced if damaged or destroyed in a flood, but not to its original form. For example, a farming operation would replace an old dairy barn currently used for storage with a storage building of pole, or some other type of less costly construction found currently in storage buildings.
- The lender may calculate the insurable value as the ''demolition/removal cost value,'' that is the cost to demolish the remaining structure and remove the debris. The ''demolition/removal cost value'' may be used when a building is not important to the ongoing nature of the business and as such would not be replaced if damaged or destroyed by a flood. The amount of flood insurance should be calculated by the lender and/or borrower to be at least the cost of demolition and removal of the insured debris.

Regardless of what method the lender and/or borrower selects to determine insurable value (replacement cost value or one of the two alternatives), all terms and conditions of the Standard Flood Insurance Policy apply including its Loss Settlement provision.◄

Force placement. In response to comments received regarding the force placement of flood insurance, the Agencies are proposing new questions and answers 60, 61, and 62, which would be added to Section X to address the following force-placement issues: whether a borrower may be charged for the cost of flood insurance coverage during the 45-day notice period, when the 45-day notice period should begin, and how soon a lender should take action after learning that improved real estate that secures a loan is uninsured or under-insured.

Several commenters requested clarification regarding timing issues related to the 45-day notice. One commenter requested clarification on whether the 45-day notice could be sent prior to the actual date of expiration of flood insurance coverage. The Act and Regulation require the lender, or its servicer, to send notice to the borrower upon making a determination that the improved real estate collateral's insurance coverage has expired or is less than the amount required for that particular property, such as upon receipt of the notice of cancellation or expiration from the insurance provider or as a result of an internal flood policy monitoring system. The borrower must obtain flood insurance within 45 days after notification by the lender; however, the 45-day period cannot begin until the lender or servicer has sent notice to the borrower. Furthermore, the Act does not permit a lender or its servicer to send the 45-day notice to the borrower prior to the actual expiration date of the flood insurance policy.

Another commenter suggested that flood insurance be force placed through private insurers since this would allow flood insurance coverage to be immediately available instead of having to wait 45 days. Whether the lender plans to force place coverage through FEMA or private insurers, lenders must allow the borrower 45 days in which to obtain flood insurance. The Agencies are proposing new question and answer 60 to address these commenters' issues.

►*60. Can the 45-day notice period be accelerated by sending notice to the borrower prior to the actual date of expiration of flood insurance coverage?*

Answer: No. Although a lender or servicer may send a notice warning a borrower that flood insurance on the collateral is about to expire, the Act and Regulation do not allow a lender or its servicer to shorten the 45-day force-placement notice period by sending notice to the borrower prior to the actual expiration date of the flood insurance policy. The Act provides that a lender or its servicer must notify a borrower if it determines that the improved real estate collateral's insurance coverage has expired or is less than the amount required for that particular property. 42 U.S.C. 4012a(e). A lender must send the notice upon making a determination that the flood insurance coverage is inadequate or has expired, such as upon receipt of the notice of cancellation or expiration from the insurance provider or as a result of an internal flood policy monitoring system. This notice must allow the borrower 45 days in which to obtain flood insurance.◄

Three commenters asserted that it would be appropriate for the Agencies to allow a reasonable period to implement force placement after the end of the 45-day notice period. The Regulation provides that the lender or its servicer shall purchase insurance on the borrower's behalf if the borrower fails to obtain flood insurance within 45 days after notification. Given that the lender is already aware during the 45-day notice period that it may be required to force place insurance if there is no response from the borrower, any delay should be brief. Where there is a brief delay in force placing required insurance, the Agencies will expect the lender to provide a reasonable explanation for the delay. The Agencies

Copyright © 2009 Association of Corporate Counsel

are proposing new question and answer 61 to address these commenters' concern.

One commenter suggested that a lender's procurement of the flood insurance binder should be acceptable under the Act and Regulation to satisfy the force placement requirement. The Agencies believe that the insurance binder may provide a reasonable explanation for a delay in force placing the formal flood insurance policy. However, an insurance binder is proof only of temporary coverage for a limited period of time until the formal insurance policy is either accepted or denied. Lenders should have sufficient internal controls in place to ensure that if a formal policy is not issued, it should force place required insurance immediately.

►*61. When must the lender have flood insurance in place if the borrower has not obtained adequate insurance within the 45-day notice period?*

Answer: The Regulation provides that the lender or its servicer *shall* purchase insurance on the borrower's behalf if the borrower fails to obtain flood insurance within 45 days after notification. However, where there is a brief delay in force placing required insurance, the Agencies will expect the lender to provide a reasonable explanation for the delay.◄

Two commenters asked whether it is permissible to charge a borrower for the cost of insurance during all or a portion of the 45-day notice period. Regardless of whether the flood insurance coverage is obtained through FEMA or by private means, under the Act and Regulation, lenders may not impose the cost of coverage for that 45-day period at any time. The Agencies are proposing new question and answer 62 to address this comment.

►*62. Does a lender or its servicer have the authority to charge a borrower for the cost of insurance coverage during the 45-day notice period?*

Answer: No. There is no authority under the Act and Regulation to charge a borrower for a force-placed flood insurance policy until the 45-day notice period has expired. The ability to impose the costs of force placed flood insurance on a borrower commences 45 days after notification to the borrower of a lack of insurance or of inadequate insurance coverage. Therefore, lenders may not charge borrowers for coverage during the 45-day notice period. This holds true regardless of whether the force placed flood insurance is obtained through the NFIP or a private provider.◄

Public Comments

The Agencies specifically invite public comment on the proposed new questions and answers. If financial institutions, bank examiners, community groups, or other interested parties have unanswered questions or comments about the Agencies' flood insurance regulation, they should submit them to the Agencies. The Agencies will consider including these questions and answers in future guidance.

Solicitation of Comments Regarding the Use of ''Plain Language''

Section 722 of the Gramm-Leach-Bliley Act of 1999, 12 U.S.C. 4809, requires the Federal banking Agencies to use ''plain language'' in all proposed and final rules published after January 1, 2000. Although this document is not a proposed rule, comments are nevertheless invited on whether the proposed questions and answers are stated clearly and how they might be revised to be easier to read.

The text of the Interagency Questions and Answers follows:

Interagency Questions and Answers Regarding Flood Insurance

The Interagency Questions and Answers are organized by topic. Each topic addresses a major area of the Act and Regulation. For ease of reference, the following terms are used throughout this document: ''Act'' refers to the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as revised by the National Flood Insurance Reform Act of 1994 (codified at 42 U.S.C. 4001 *et seq.*). ''Regulation'' refers to each agency's current final rule.[11] The OCC, Board, FDIC, OTS, NCUA, and FCA (collectively, ''the Agencies'') are providing answers to questions pertaining to the following topics:

I. Determining When Certain Loans Are Designated Loans for Which Flood Insurance Is Required Under the Act and Regulation
II. Determining the Appropriate Amount of Flood Insurance Required Under the Act and Regulation
III. Exemptions From the Mandatory Flood Insurance Requirements
IV. Flood Insurance Requirements for Construction Loans
V. Flood Insurance Requirements for Nonresidential Buildings
VI. Flood Insurance Requirements for Residential Condominiums
VII. Flood Insurance Requirements for Home Equity Loans, Lines of Credit, Subordinate Liens, and Other Security Interests in Collateral Located in an SFHA
VIII. Flood Insurance Requirements in the Event of the Sale or Transfer of a Designated Loan and/or Its Servicing Rights
IX. Escrow Requirements
X. Force Placement of Flood Insurance
XI. Private Insurance Policies
XII. Required Use of Standard Flood Hazard Determination Form (SFHDF)
XIII. Flood Determination Fees
XIV. Flood Zone Discrepancies
XV. Notice of Special Flood Hazards and Availability of Federal Disaster Relief
XVI. Mandatory Civil Money Penalties

[11] The Agencies' rules are codified at 12 CFR part 22 (OCC), 12 CFR part 208 (Board), 12 CFR part 339 (FDIC), 12 CFR part 572 (OTS), 12 CFR part 614 (FCA), and 12 CFR part 760 (NCUA).

I. Determining When Certain Loans Are Designated Loans for Which Flood Insurance Is Required Under the Act and Regulation

1. Does the Regulation apply to a loan where the building or mobile home securing such loan is located in a community that does not participate in the National Flood Insurance Program (NFIP)?

Answer: Yes. The Regulation does apply; however, a lender need not require borrowers to obtain flood insurance for a building or mobile home located in a community that does not participate in the NFIP, even if the building or mobile home securing the loan is located in a Special Flood Hazard Area (SFHA). Nonetheless, a lender, using the standard Special Flood Hazard Determination Form (SFHDF), must still determine whether the building or mobile home is located in an SFHA. If the building or mobile home is determined to be located in an SFHA, a lender is required to notify the borrower. In this case, a lender, generally, may make a conventional loan without requiring flood insurance, if it chooses to do so. However, a lender may not make a government-guaranteed or insured loan, such as a Small Business Administration, Veterans Administration, or Federal Housing Administration loan secured by a building or mobile home located in an SFHA in a community that does not participate in the NFIP. *See* 42 U.S.C. 4106(a). Also, a lender is responsible for exercising sound risk management practices to ensure that it does not make a loan secured by a building or mobile home located in an SFHA where no flood insurance is available, if doing so would be an unacceptable risk.

2. What is a lender's responsibility if a particular building or mobile home that secures a loan, due to a map change, is no longer located within an SFHA?

Answer: The lender is no longer obligated to require mandatory flood insurance; however, the borrower can

Copyright © 2009 Association of Corporate Counsel

elect to convert the existing NFIP policy to a Preferred Risk Policy. For risk management purposes, the lender may, by contract, continue to require flood insurance coverage.

3. Does a lender's purchase of a loan, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act, from another lender trigger any requirements under the Regulation?

Answer: No. A lender's purchase of a loan, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act, alone, is not an event that triggers the Regulation's requirements, such as making a new flood determination or requiring a borrower to purchase flood insurance. Requirements under the Regulation, generally, are triggered when a lender makes, increases, extends, or renews a designated loan. A lender's purchase of a loan does not fall within any of those categories.

However, if a lender becomes aware at any point during the life of a designated loan that flood insurance is required, the lender must comply with the Regulation, including force placing insurance, if necessary. Depending upon the circumstances, safety and soundness considerations may sometimes necessitate such due diligence upon purchase of a loan as to put the lender on notice of lack of adequate flood insurance. If the purchasing lender subsequently extends, increases, or renews a designated loan, it must also comply with the Regulation.

4. How do the Agencies enforce the mandatory purchase requirements under the Act and Regulation when a lender participates in a loan syndication or participation?

Answer: As with purchased loans, the acquisition by a lender of an interest in a loan either by participation or syndication after that loan has been made does not trigger the requirements of Act or Regulation, such as making a new flood determination or requiring a borrower to purchase flood insurance. Nonetheless, as with purchased loans, depending upon the circumstances, safety and soundness considerations may sometimes necessitate that the lender undertake due diligence to protect itself against the risk of flood or other types of loss.

Lenders who pool or contribute funds that will be simultaneously advanced to a borrower or borrowers as a loan secured by improved real estate would all be subject to the requirements of Act or Regulation. Federal flood insurance requirements would also apply to those situations where such a group of lenders decides to extend, renew or increase a loan. Although the agreement among the lenders may assign compliance duties to a lead lender or agent, and include clauses in which the lead lender or agent indemnifies participating lenders against flood losses, each participating lender remains individually responsible for ensuring compliance with the Act and Regulation. Therefore, the Agencies will examine whether the regulated institution/participating lender has performed upfront due diligence to ensure both that the lead lender or agent has undertaken the necessary activities to ensure that the borrower obtains appropriate flood insurance and that the lead lender or agent has adequate controls to monitor the loan(s) on an ongoing basis for compliance with the flood insurance requirements. Further, the Agencies expect the participating lender to have adequate controls to monitor the activities of the lead lender or agent to ensure compliance with flood insurance requirements over the term of the loan.

5. Does the Regulation apply to loans that are being restructured or modified?

Answer: It depends. If the loan otherwise meets the definition of a designated loan and if the lender increases the amount of the loan, or extends or renews the terms of the original loan, then the Regulation applies.

6. Are table funded loans treated as new loan originations?

Answer: Yes. Table funding, as defined under HUD's Real Estate Settlement Procedure Act (RESPA) rule, 24 CFR 3500.2, is a settlement at which a loan is funded by a contemporaneous advance of loan funds and the assignment of the loan to the person advancing the funds. A loan made through a table funding process is treated as though the party advancing the funds has originated the loan. The funding party is required to comply with the Regulation. The table funding lender can meet the administrative requirements of the Regulation by requiring the party processing and underwriting the application to perform those functions on its behalf.

7. Is a lender required to perform a review of its, or of its servicer's, existing loan portfolio for compliance with the flood insurance requirements under the Act and Regulation?

Answer: No. Apart from the requirements mandated when a loan is made, increased, extended, or renewed, a regulated lender need only review and take action on any part of its existing portfolio for safety and soundness purposes, or if it knows or has reason to know of the need for NFIP coverage. Regardless of the lack of such requirement in the Act and Regulation, however, sound risk management practices may lead a lender to conduct scheduled periodic reviews that track the need for flood insurance on a loan portfolio.

II. Determining the Appropriate Amount of Flood Insurance Required Under the Act and Regulation

8. The Regulation states that the amount of flood insurance required "must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act." What is meant by the "maximum limit of coverage available for the particular type of property under the Act"?

Answer: "The maximum limit of coverage available for the particular type of property under the Act" depends on the value of the secured collateral. First, under the NFIP, there are maximum caps on the amount of insurance available. For single-family and two-to-four family dwellings and other residential buildings located in a participating community under the regular program, the maximum cap is $250,000. For nonresidential structures located in a participating community under the regular program, the maximum cap is $500,000. (In participating communities that are under the emergency program phase, the caps are $35,000 for single-family and two-to-four family dwellings and other residential structures, and $100,000 for nonresidential structures).

In addition to the maximum caps under the NFIP, the Regulation also provides that "flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the property is located," which is commonly referred to as the "insurable value" of a structure. The NFIP does not insure land; therefore, land values should not be included in the calculation.

An NFIP policy will not cover an amount exceeding the "insurable value" of the structure. In determining coverage amounts for flood insurance, lenders often follow the same practice used to establish other hazard insurance coverage amounts. However, unlike the insurable valuation used to underwrite most other hazard insurance policies, the insurable value of improved real

estate for flood insurance purposes also includes the repair or replacement cost of the foundation and supporting structures. It is very important to calculate the correct insurable value of the property; otherwise, the lender might inadvertently require the borrower to purchase too much or too little flood insurance coverage. For example, if the lender fails to exclude the value of the land when determining the insurable value of the improved real estate, the borrower will be asked to purchase coverage that exceeds the amount the NFIP will pay in the event of a loss. (Please note, however, when taking a security interest in improved real estate where the value of the land, excluding the value of the improvements, is sufficient collateral for the debt, the lender must nonetheless require flood insurance to cover the value of the structure if it is located in a participating community's SFHA).

9. What is insurable value?

Answer: [Reserved]

10. Are there any alternatives to the definition of insurable value?

Answer: [Reserved]

11. What are examples of residential buildings?

Answer: Residential buildings include one-to-four family dwellings; apartment or other residential buildings containing more than four dwelling units; condominiums and cooperatives in which at least 75 percent of the square footage is residential; hotels or motels where the normal occupancy of a guest is six months or more; and rooming houses that have more than four roomers. A residential building may have incidental nonresidential use, such as an office or studio, as long as the total area of such incidental occupancy is limited to less than 25 percent of the square footage of the building, or 50 percent for single-family dwellings.

12. What are examples of nonresidential buildings?

Answer: Nonresidential buildings include those used for small businesses, churches, schools, farm activities (including grain bins and silos), pool houses, clubhouses, recreation, mercantile structures, agricultural and industrial structures, warehouses, hotels and motels with normal room rentals for less than six months' duration, nursing homes, and mixed-use buildings with less than 75 percent residential square footage.

13. How much insurance is required on a building located in an SFHA in a participating community?

Answer: The amount of insurance required by the Act and Regulation is the lesser of:

- The outstanding principal balance of the loan(s); or
- The maximum amount of insurance available under the NFIP, which is the lesser of:
  - ○ The maximum limit available for the type of structure; or
  - ○ The ''insurable value'' of the structure.

Example: (Calculating insurance required on a nonresidential building):

Loan security includes one equipment shed located in an SFHA in a participating community under the regular program.

- Outstanding loan principal is $300,000.
- Maximum amount of insurance available under the NFIP:
  - ○ Maximum limit available for type of structure is $500,000 per building (nonresidential building).
  - ○ Insurable value of the equipment shed is $30,000.

The minimum amount of insurance required by the Regulation for the equipment shed is $30,000.

14. Is flood insurance required for each building when the real estate security contains more than one building located in an SFHA in a participating community? If so, how much coverage is required?

Answer: Yes. The lender must determine the amount of insurance required on each building and add these individual amounts together. The total amount of required flood insurance is the lesser of:

- The outstanding principal balance of the loan(s); or
- The maximum amount of insurance available under the NFIP, which is the lesser of:
  - ○ The maximum limit available for the type of structures; or
  - ○ The ''insurable value'' of the structures.

The amount of total required flood insurance can be allocated among the secured buildings in varying amounts, but all buildings in an SFHA must have some coverage.

Example: Lender makes a loan in the principal amount of $150,000 secured by five nonresidential buildings, only three of which are located in SFHAs within participating communities.

- Outstanding loan principal is $150,000.
- Maximum amount of insurance available under the NFIP.
  - ○ Maximum limit available for the type of structure is $500,000 per building (nonresidential buildings); or
  - ○ Insurable value (for each nonresidential building for which insurance is required, which is $100,000, or $300,000 total).

Amount of insurance required for the three buildings is $150,000. This amount of required flood insurance could be allocated among the three buildings in varying amounts, so long as each is covered by flood insurance.

15. If the insurable value of a building or mobile home, located in an SFHA in which flood insurance is available under the Act, securing a designated loan is less than the outstanding principal balance of the loan, must a lender require the borrower to obtain flood insurance up to the balance of the loan?

Answer: No. The Regulation provides that the amount of flood 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 a particular type of property under the Act. The Regulation also provides that flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the building or mobile home is located. Since the NFIP policy does not cover land value, lenders should determine the amount of insurance necessary based on the insurable value of the improvements.

16. Can a lender require more flood insurance than the minimum required by the Regulation?

Answer: Yes. Lenders are permitted to require more flood insurance coverage than required by the Regulation. The borrower or lender may have to seek such coverage outside the NFIP. Each lender has the responsibility to tailor its own flood insurance policies and procedures to suit its business needs and protect its ongoing interest in the collateral. However, lenders should avoid creating situations where a building is ''over-insured.''

17. Can a lender allow the borrower to use the maximum deductible to reduce the cost of flood insurance?

Answer: Yes. However, it is not a sound business practice for a lender to allow the borrower to use the maximum deductible amount in every situation. A lender should determine the reasonableness of the deductible on a case-by-case basis, taking into account the risk that such a deductible would pose to the borrower and lender. A lender may not allow the borrower to use a deductible amount equal to the insurable value of the property to avoid

Copyright © 2009 Association of Corporate Counsel

Federal Register / Vol. 74, No. 138 / Tuesday, July 21, 2009 / Notices 35937

the mandatory purchase requirement for flood insurance.

III. Exemptions From the Mandatory Flood Insurance Requirements

18. What are the exemptions from coverage?

Answer: There are only two exemptions from the purchase requirements. The first applies to State-owned property covered under a policy of self-insurance satisfactory to the Director of FEMA. The second applies if both the original principal balance of the loan is $5,000 or less, and the original repayment term is one year or less.

IV. Flood Insurance Requirements for Construction Loans

19. Is a loan secured only by land that is located in an SFHA in which flood insurance is available under the Act and that will be developed into buildable lot(s) a designated loan that requires flood insurance?

Answer: No. A designated loan is defined as a loan secured by a building or mobile home that is located or to be located in an SFHA in which flood insurance is available under the Act. Any loan secured only by land that is located in an SFHA in which flood insurance is available is not a designated loan since it is not secured by a building or mobile home.

20. Is a loan secured or to be secured by a building in the course of construction that is located or to be located in an SFHA in which flood insurance is available under the Act a designated loan?

Answer: Yes. Therefore, a lender must always make a flood determination prior to loan origination to determine whether a building to be constructed that is security for the loan is located or will be located in an SFHA in which flood insurance is available under the Act. If so, then the loan is a designated loan and the lender must provide the requisite notice to the borrower prior to loan origination that mandatory flood insurance is required. The lender must then comply with the mandatory purchase requirement under the Act and Regulation.

21. Is a building in the course of construction that is located in an SFHA in which flood insurance is available under the Act eligible for coverage under an NFIP policy?

Answer: Yes. FEMA's *Flood Insurance Manual*, under general rules, states:

Buildings in the course of construction that have yet to be walled and roofed are eligible for coverage except when construction has been halted for more than 90 days and/or if the lowest floor used for rating purposes is below the Base Flood Elevation (BFE). Materials or supplies intended for use in such construction, alteration, or repair are not insurable unless they are contained within an enclosed building on the premises or adjacent to the premises.

FEMA, *Flood Insurance Manual* at p. GR 4 (FEMA's *Flood Insurance Manual* is updated every six months). The definition section of the *Flood Insurance Manual* defines ''start of construction'' in the case of new construction as ''either the first placement of permanent construction of a building on site, such as the pouring of a slab or footing, the installation of piles, the construction of columns, or any work beyond the stage of excavation; or the placement of a manufactured (mobile) home on a foundation.'' FEMA, *Flood Insurance Manual*, at p. DEF 9. While an NFIP policy may be purchased prior to the start of construction, as a practical matter, coverage under an NFIP policy is not effective until actual construction commences or when materials or supplies intended for use in such construction, alteration, or repair are contained in an enclosed building on the premises or adjacent to the premises.

22. When must a lender require the purchase of flood insurance for a loan secured by a building in the course of construction that is located in an SFHA in which flood insurance is available?

Answer: Under the Act, as implemented by the Regulation, a lender may not make, increase, extend, or renew any loan secured by a building or a mobile home, located or to be located in an SFHA in which flood insurance is available, unless the property is covered by adequate flood insurance for the term of the loan. One way for lenders to comply with the mandatory purchase requirement for a loan secured by a building in the course of construction that is located in an SFHA is to require borrowers to have a flood insurance policy in place at the time of loan origination.

Alternatively, a lender may allow a borrower to defer the purchase of flood insurance until either a foundation slab has been poured and/or an elevation certificate has been issued or, if the building to be constructed will have its lowest floor below the Base Flood Elevation, when the building is walled and roofed.[12] However, the lender must require the borrower to have flood insurance in place before the lender disburses funds to pay for building construction (except as necessary to pour the slab or perform preliminary site work, such as laying utilities, clearing brush, or the purchase and/or delivery of building materials) on the property securing the loan. If the lender elects this approach and does not require flood insurance to be obtained at loan origination, then it must have adequate internal controls in place at origination to ensure that the borrower obtains flood insurance no later than when the foundation slab has been poured and/or an elevation certificate has been issued.

23. Does the 30-day waiting period apply when the purchase of the flood insurance policy is deferred in connection with a construction loan?

Answer: No. The NFIP will rely on an insurance agent's representation on the application for flood insurance that the purchase of insurance has been properly deferred unless there is a loss during the first 30 days of the policy period. In that case, the NFIP will require documentation of the loan transaction, such as settlement papers, before adjusting the loss.

V. Flood Insurance Requirements for Nonresidential Buildings

24. Some borrowers have buildings with limited utility or value and, in many cases, the borrower would not replace them if lost in a flood. Is a lender required to mandate flood insurance for such buildings?

Answer: Yes. Under the Regulation, lenders must require flood insurance on real estate improvements when those improvements are part of the property securing the loan and are located in an SFHA and in a participating community.

The lender may consider ''carving out'' buildings from the security it takes on the loan. However, the lender should fully analyze the risks of this option. In particular, a lender should consider whether it would be able to market the property securing its loan in the event of foreclosure. Additionally, the lender should consider any local zoning issues or other issues that would affect its collateral.

[12] FEMA, *Mandatory Purchase of Flood Insurance Guidelines*, at 30.

Copyright © 2009 Association of Corporate Counsel

25. What are a lender's requirements under the Regulation for a loan secured by multiple buildings located throughout a large geographic area where some of the buildings are located in an SFHA in which flood insurance is available and other buildings are not? What if the buildings are located in several jurisdictions or counties where some of the communities participate in the NFIP and others do not?

Answer: A lender is required to make a determination as to whether the improved real property securing the loan is in an SFHA. If secured improved real estate is located in an SFHA, but not in a participating community, no flood insurance is required, although a lender can require the purchase of flood insurance (from a private insurer) as a matter of safety and soundness. Conversely, where secured improved real estate is located in a participating community but not in an SFHA, no insurance is required. A lender must provide appropriate notice and require the purchase of flood insurance for designated loans located in an SFHA in a participating community.

VI. Flood Insurance Requirements for Residential Condominiums

26. Are residential condominiums, including multi-story condominium complexes, subject to the statutory and regulatory requirements for flood insurance?

Answer: Yes. The mandatory flood insurance purchase requirements under the Act and Regulation apply to loans secured by individual residential condominium units, including those located in multi-story condominium complexes, located in an SFHA in which flood insurance is available under the Act. The mandatory purchase requirements also apply to loans secured by other condominium property, such as loans to a developer for construction of the condominium or loans to a condominium association.

27. What is an NFIP Residential Condominium Building Association Policy (RCBAP)?

Answer: The RCBAP is a master policy for residential condominiums issued by FEMA. A residential condominium building is defined as having 75 percent or more of the building's floor area in residential use. It may be purchased only by condominium owners associations. The RCBAP covers both the common and individually owned building elements within the units, improvements within the units, and contents owned in common (if contents coverage is purchased). The maximum amount of building coverage that can be purchased under an RCBAP is either 100 percent of the replacement cost value of the building, including amounts to repair or replace the foundation and its supporting structures, or the total number of units in the condominium building times $250,000, whichever is less. RCBAP coverage is available only for residential condominium buildings in Regular Program communities.

28. What is the amount of flood insurance coverage that a lender must require with respect to residential condominium units, including those located in multi-story condominium complexes, to comply with the mandatory purchase requirements under the Act and the Regulation?

Answer: To comply with the Regulation, the lender must ensure that the minimum amount of flood insurance covering the condominium unit is the lesser of:

- The outstanding principal balance of the loan(s); or
- The maximum amount of insurance available under the NFIP, which is the lesser of:
  - The maximum limit available for the residential condominium unit; or
  - The ''insurable value'' allocated to the residential condominium unit, which is the replacement cost value of the condominium building divided by the number of units.

Effective October 1, 2007, FEMA required agents to provide on the declaration page of the RCBAP the replacement cost value of the condominium building and the number of units. Lenders may rely on the replacement cost value and number of units on the RCBAP declaration page in determining insurable value unless they have reason to believe that such amounts clearly conflict with other available information. If there is a conflict, the lender should notify the borrower of the facts that cause the lender to believe there is a conflict. If the lender believes that the borrower is underinsured, it should require the purchase of a Dwelling Policy for supplemental coverage.

Assuming that the outstanding principal balance of the loan is greater than the maximum amount of coverage available under the NFIP, the lender must require a borrower whose loan is secured by a residential condominium unit to either:

- Ensure the condominium owners association has purchased an NFIP Residential Condominium Building Association Policy (RCBAP) covering either 100 percent of the insurable value (replacement cost) of the building, including amounts to repair or replace the foundation and its supporting structures, or the total number of units in the condominium building times $250,000, whichever is less; or
- Obtain a dwelling policy if there is no RCBAP, as explained in question and answer 29, or if the RCBAP coverage is less than 100 percent of the replacement cost value of the building or the total number of units in the condominium building times $250,000, whichever is less, as explained in question and answer 30.

Example: Lender makes a loan in the principal amount of $300,000 secured by a condominium unit in a 50-unit condominium building, which is located in an SFHA within a participating community, with a replacement cost of $15 million and insured by an RCBAP with $12.5 million of coverage.

- Outstanding principal balance of loan is $300,000.
- Maximum amount of coverage available under the NFIP, which is the lesser of:
  - Maximum limit available for the residential condominium unit is $250,000; or
  - Insurable value of the unit based on 100 percent of the building's replacement cost value ($15 million ÷ 50 = $300,000).

The lender does not need to require additional flood insurance since the RCBAP's $250,000 per unit coverage ($12.5 million ÷ 50 = $250,000) satisfies the Regulation's mandatory flood insurance requirement. (This is the lesser of the outstanding principal balance ($300,000), the maximum coverage available under the NFIP ($250,000), or the insurable value ($300,000)).

The guidance in this question and answer will apply to any loan that is made, increased, extended, or renewed after the effective date of this revised guidance. This revised guidance will not apply to any loans made prior to the effective date of this guidance until a trigger event occurs (that is, the loan is refinanced, extended, increased, or renewed) in connection with the loan. Absent a new trigger event, loans made prior to the effective date of this new guidance will be considered compliant if they complied with the Agencies' previous guidance, which stated that an RCBAP that provided 80 percent RCV coverage was sufficient.

29. What action must a lender take if there is no RCBAP coverage?

Answer: If there is no RCBAP, either because the condominium association will not obtain a policy or because individual unit owners are responsible for obtaining their own insurance, then the lender must require the individual unit owner/borrower to obtain a dwelling policy in an amount sufficient to meet the requirements outlined in Question 28.

A dwelling policy is available for condominium unit owners' purchase when there is no or inadequate RCBAP

Copyright © 2009 Association of Corporate Counsel

coverage. When coverage by an RCBAP is inadequate, the dwelling policy may provide individual unit owners with supplemental building coverage to the RCBAP. The RCBAP and the dwelling policy are coordinated such that the dwelling policy purchased by the unit owner responds to shortfalls on building coverage pertaining either to improvements owned by the insured unit owner or to assessments. However, the dwelling policy does not extend the RCBAP limits, nor does it enable the condominium association to fill in gaps in coverage.

Example: The lender makes a loan in the principal amount of $175,000 secured by a condominium unit in a 50-unit condominium building, which is located in an SFHA within a participating community, with a replacement cost value of $10 million; however, there is no RCBAP.

- Outstanding principal balance of loan is $175,000.
- Maximum amount of coverage available under the NFIP, which is the lesser of:
  - Maximum limit available for the residential condominium unit is $250,000; or
  - Insurable value of the unit based on 100 percent of the building's replacement cost value ($10 million ÷ 50 = $200,000).

The lender must require the individual unit owner/borrower to purchase a flood insurance dwelling policy in the amount of at least $175,000, since there is no RCBAP, to satisfy the Regulation's mandatory flood insurance requirement. (This is the lesser of the outstanding principal balance ($175,000), the maximum coverage available under the NFIP ($250,000), or the insurable value ($200,000).)

30. What action must a lender take if the RCBAP coverage is insufficient to meet the Regulation's mandatory purchase requirements for a loan secured by an individual residential condominium unit?

Answer: If the lender determines that flood insurance coverage purchased under the RCBAP is insufficient to meet the Regulation's mandatory purchase requirements, then the lender should request that the individual unit owner/borrower ask the condominium association to obtain additional coverage that would be sufficient to meet the Regulation's requirements (*see* question and answer 28). If the condominium association does not obtain sufficient coverage, then the lender must require the individual unit owner/borrower to purchase a dwelling policy in an amount sufficient to meet the Regulation's flood insurance requirements. The amount of coverage under the dwelling policy required to be purchased by the individual unit owner would be the difference between the RCBAP's coverage allocated to that unit and the Regulation's mandatory flood insurance requirements (*see* question and answer 29).

Example: Lender makes a loan in the principal amount of $300,000 secured by a condominium unit in a 50-unit condominium building, which is located in an SFHA within a participating community, with a replacement cost value of $10 million; however, the RCBAP is at 80 percent of replacement cost value ($8 million or $160,000 per unit).

- Outstanding principal balance of loan is $300,000.
- Maximum amount of coverage available under the NFIP, which is the lesser of:
  - Maximum limit available for the residential condominium unit is $250,000; or
  - Insurable value of the unit based on 100 percent of the building's replacement value ($10 million ÷ 50 = $200,000).

The lender must require the individual unit owner/borrower to purchase a flood insurance dwelling policy in the amount of $40,000 to satisfy the Regulation's mandatory flood insurance requirement of $200,000. (This is the lesser of the outstanding principal balance ($300,000), the maximum coverage available under the NFIP ($250,000), or the insurable value ($200,000).) The RCBAP fulfills only $160,000 of the Regulation's flood insurance requirement.

While the individual unit owner's purchase of a separate dwelling policy that provides for adequate flood insurance coverage under the Regulation will satisfy the Regulation's mandatory flood insurance requirements, the lender and the individual unit owner/borrower may still be exposed to additional risk of loss. Lenders are encouraged to apprise borrowers of this risk. The dwelling policy provides individual unit owners with supplemental building coverage to the RCBAP. The policies are coordinated such that the dwelling policy purchased by the unit owner responds to shortfalls on building coverage pertaining either to improvements owned by the insured unit owner or to assessments. However, the dwelling policy does not extend the RCBAP limits, nor does it enable the condominium association to fill in gaps in coverage.

The risk arises because the individual unit owner's dwelling policy may contain claim limitations that prevent the dwelling policy from covering the individual unit owner's share of the co-insurance penalty, which is triggered when the amount of insurance under the RCBAP is less than 80 percent of the building's replacement cost value at the time of loss. In addition, following a major flood loss, the insured unit owner may have to rely upon the condominium association's and other unit owners' financial ability to make the necessary repairs to common elements in the building, such as electricity, heating, plumbing, and elevators. It is incumbent on the lender to understand these limitations.

31. What must a lender do when a loan secured by a residential condominium unit is in a complex whose condominium association allows its existing RCBAP to lapse?

Answer: If a lender determines at any time during the term of a designated loan that the loan is not covered by flood insurance or is covered by such insurance in an amount less than that required under the Act and the Regulation, the lender must notify the individual unit owner/borrower of the requirement to maintain flood insurance coverage sufficient to meet the Regulation's mandatory requirements. The lender should encourage the individual unit owner/borrower to work with the condominium association to acquire a new RCBAP in an amount sufficient to meet the Regulation's mandatory flood insurance requirement (*see* question and answer 28). Failing that, the lender must require the individual unit owner/borrower to obtain a flood insurance dwelling policy in an amount sufficient to meet the Regulation's mandatory flood insurance requirement (*see* questions and answers 29 and 30). If the borrower/unit owner or the condominium association fails to purchase flood insurance sufficient to meet the Regulation's mandatory requirements within 45 days of the lender's notification to the individual unit owner/borrower of inadequate insurance coverage, the lender must force place the necessary flood insurance.

32. How does the RCBAP's co-insurance penalty apply in the case of residential condominiums, including those located in multi-story condominium complexes?

Answer: In the event the RCBAP's coverage on a condominium building at the time of loss is less than 80 percent of either the building's replacement cost or the maximum amount of insurance available for that building under the NFIP (whichever is less), then the loss payment, which is subject to a co-insurance penalty, is determined as follows (subject to all other relevant conditions in this policy, including those pertaining to valuation, adjustment, settlement, and payment of loss):

A. Divide the actual amount of flood insurance carried on the condominium building at the time of loss by 80 percent of either its replacement cost or the maximum amount of insurance

Copyright © 2009 Association of Corporate Counsel

35940 Federal Register / Vol. 74, No. 138 / Tuesday, July 21, 2009 / Notices

available for the building under the NFIP, whichever is less.

B. Multiply the amount of loss, before application of the deductible, by the figure determined in A above.

C. Subtract the deductible from the figure determined in B above.

The policy will pay the amount determined in C above, or the amount of insurance carried, whichever is less.

Example 1: (Inadequate insurance amount to avoid penalty).

Replacement value of the building: $250,000.

80% of replacement value of the building: $200,000.

Actual amount of insurance carried: $180,000.

Amount of the loss: $150,000.

Deductible: $ 500.

Step A: 180,000 ÷ 200,000 = .90

(90% of what should be carried to avoid co-insurance penalty)

Step B: 150,000 × .90 = 135,000

Step C: 135,000 − 500 = 134,500

The policy will pay no more than $134,500. The remaining $15,500 is not covered due to the co-insurance penalty ($15,000) and application of the deductible ($500). Unit owners' dwelling policies will not cover any assessment that may be imposed to cover the costs of repair that are not covered by the RCBAP.

Example 2: (Adequate insurance amount to avoid penalty).

Replacement value of the building: $250,000.

80% of replacement value of the building: $200,000.

Actual amount of insurance carried: $200,000.

Amount of the loss: $150,000.

Deductible: $ 500.

Step A: 200,000 ÷ 200,000 = 1.00

(100% of what should be carried to avoid co-insurance penalty)

Step B: 150,000 × 1.00 = 150,000

Step C: 150,000 − 500 = 149,500

In this example there is no co-insurance penalty, because the actual amount of insurance carried meets the 80 percent requirement to avoid the co-insurance penalty. The policy will pay no more than $149,500 ($150,000 amount of loss minus the $500 deductible). This example also assumes a $150,000 outstanding principal loan balance.

33. What are the major factors involved with the individual unit owner's dwelling policy's coverage limitations with respect to the condominium association's RCBAP coverage?

Answer: The following examples demonstrate how the unit owner's dwelling policy may cover in certain loss situations:

Example 1: (RCBAP insured to at least 80 percent of building replacement cost).

- If the unit owner purchases building coverage under the dwelling policy and if there is an RCBAP covering at least 80 percent of the building replacement cost value, the loss assessment coverage under the dwelling policy will pay that part of a loss that exceeds 80 percent of the association's building replacement cost allocated to that unit.
- The loss assessment coverage under the dwelling policy will not cover the association's policy deductible purchased by the condominium association.
- If building elements within units have also been damaged, the dwelling policy pays to repair building elements after the RCBAP limits that apply to the unit have been exhausted. Coverage combinations cannot exceed the total limit of $250,000 per unit.

Example 2: (RCBAP insured to less than 80 percent of building replacement cost).

- If the unit owner purchases building coverage under the dwelling policy and there is an RCBAP that was insured to less than 80 percent of the building replacement cost value at the time of loss, the loss assessment coverage cannot be used to reimburse the association for its co-insurance penalty.
- Loss assessment is available only to cover the building damages in excess of the 80-percent required amount at the time of loss. Thus, the covered damages to the condominium association building must be greater than 80 percent of the building replacement cost value at the time of loss before the loss assessment coverage under the dwelling policy becomes available. Under the dwelling policy, covered repairs to the unit, if applicable, would have priority in payment over loss assessments against the unit owner.

Example 3: (No RCBAP),

- If the unit owner purchases building coverage under the dwelling policy and there is no RCBAP, the dwelling policy covers assessments against unit owners for damages to common areas up to the dwelling policy limit.
- However, if there is damage to the building elements of the unit as well, the combined payment of unit building damages, which would apply first, and the loss assessment may not exceed the building coverage limit under the dwelling policy.

VII. Flood Insurance Requirements for Home Equity Loans, Lines of Credit, Subordinate Liens, and Other Security Interests in Collateral Located in an SFHA

34. Is a home equity loan considered a designated loan that requires flood insurance?

Answer: Yes. A home equity loan is a designated loan, regardless of the lien priority, if the loan is secured by a building or a mobile home located in an SFHA in which flood insurance is available under the Act.

35. Does a draw against an approved line of credit secured by a building or mobile home, which is located in an SFHA in which flood insurance is available under the Act, require a flood determination under the Regulation?

Answer: No. While a line of credit secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act is a designated loan and, therefore, requires a flood determination before the loan is made, draws against an approved line do not require further determinations. However, a request made for an *increase* in an approved line of credit may require a new determination, depending upon whether a previous determination was done. (*See* response to question 68 in Section XIII. Required use of Standard Flood Hazard Determination Form.)

36. When a lender makes, increases, extends or renews a second mortgage secured by a building or mobile home located in an SFHA, how much flood insurance must the lender require?

Answer: The lender must ensure that adequate flood insurance is in place or require that additional flood insurance coverage be added to the flood insurance policy in the amount of the lesser of either the combined total outstanding principal balance of the first and second loan, the maximum amount available under the Act (currently $250,000 for a residential building and $500,000 for a nonresidential building), or the insurable value of the building or mobile home. The junior lienholder should also ensure that the borrower adds the junior lienholder's name as mortgagee/loss payee to the existing flood insurance policy. Given the provisions of NFIP policies, a lender cannot comply with the Act and Regulation by requiring the purchase of an NFIP flood insurance policy only in the amount of the outstanding principal balance of the second mortgage without regard to the amount of flood insurance coverage on a first mortgage.

A junior lienholder should work with the senior lienholder, the borrower, or with both of these parties, to determine how much flood insurance is needed to cover improved real estate collateral. A junior lienholder should obtain the borrower's consent in the loan agreement or otherwise for the junior lienholder to obtain information on balance and existing flood insurance coverage on senior lien loans from the senior lienholder.

Junior lienholders also have the option of pulling a borrower's credit report and using the information from that document to establish how much flood insurance is necessary upon increasing, extending or renewing a junior lien, thus protecting the interests of the junior lienholder, the senior lienholders, and the borrower. In the limited situation where a junior lienholder or its servicer is unable to

Copyright © 2009 Association of Corporate Counsel

Federal Register / Vol. 74, No. 138 / Tuesday, July 21, 2009 / Notices 35941

obtain the necessary information about the amount of flood insurance in place on the outstanding balance of a senior lien (for example, in the context of a loan renewal), the lender may presume that the amount of insurance coverage relating to the senior lien in place at the time the junior lien was first established (provided that the amount of flood insurance relating to the senior lien was adequate at the time) continues to be sufficient.

Example 1: Lender A makes a first mortgage with a principal balance of $100,000, but improperly requires only $75,000 of flood insurance coverage, which the borrower satisfied by obtaining an NFIP policy. Lender B issues a second mortgage with a principal balance of $50,000. The insurable value of the residential building securing the loans is $200,000. Lender B must ensure that flood insurance in the amount of $150,000 is purchased and maintained. If Lender B were to require additional flood insurance only in an amount equal to the principal balance of the second mortgage ($50,000), its interest in the secured property would not be fully protected in the event of a flood loss because Lender A would have prior claim on $100,000 of the loss payment towards its principal balance of $100,000, while Lender B would receive only $25,000 of the loss payment toward its principal balance of $50,000.

Example 2: Lender A, who is not directly covered by the Act or Regulation, makes a first mortgage with a principal balance of $100,000 and does not require flood insurance. Lender B, who is directly covered by the Act and Regulation, issues a second mortgage with a principal balance of $50,000. The insurable value of the residential building securing the loans is $200,000. Lender B must ensure that flood insurance in the amount of $150,000 is purchased and maintained. If Lender B were to require flood insurance only in an amount equal to the principal balance of the second mortgage ($50,000) through an NFIP policy, then its interest in the secured property would not be protected in the event of a flood loss because Lender A would have prior claim on the entire $50,000 loss payment towards its principal balance of $100,000.

Example 3: Lender A made a first mortgage with a principal balance of $100,000 on improved real estate with a fair market value of $150,000. The insurable value of the residential building on the improved real estate is $90,000; however, Lender A improperly required only $70,000 of flood insurance coverage, which the borrower satisfied by purchasing an NFIP policy. Lender B later takes a second mortgage on the property with a principal balance of $10,000. Lender B must ensure that flood insurance in the amount of $90,000 (the insurable value) is purchased and maintained on the secured property to comply with the Act and Regulation. If Lender B were to require flood insurance only in an amount equal to the principal balance of the second mortgage ($10,000), its interest in the secured property would not be protected in the event of a flood loss because Lender A would have prior claim on the entire $70,000 loss payment towards the insurable value of $90,000.

37. If a borrower requesting a loan secured by a junior lien provides evidence that flood insurance coverage is in place, does the lender have to make a new determination? Does the lender have to adjust the insurance coverage?

Answer: It depends. Assuming the requirements in Section 528 of the Act (42 U.S.C. 4104b) are met and the same lender made the first mortgage, then a new determination may not be necessary, when the existing determination is not more than seven years old, there have been no map changes, and the determination was recorded on an SFHDF. If, however, a lender other than the one that made the first mortgage loan is making the junior lien loan, a new determination would be required because this lender would be deemed to be ‘‘making’’ a new loan. In either situation, the lender will need to determine whether the amount of insurance in force is sufficient to cover the lesser of the combined outstanding principal balance of all loans (including the junior lien loan), the insurable value, or the maximum amount of coverage available on the improved real estate. This will hold true whether the subordinate lien loan is a home equity loan or some other type of junior lien loan.

38. If the loan request is to finance inventory stored in a building located within an SFHA, but the building is not security for the loan, is flood insurance required?

Answer: No. The Act and the Regulation provide that a lender shall not make, increase, extend, or renew a designated loan, that is a loan secured by a building or mobile home located or to be located in an SFHA, ‘‘unless the building or mobile home and any personal property securing such loan’’ is covered by flood insurance for the term of the loan. In this example, the collateral is not the type that could secure a designated loan because it does not include a building or mobile home; rather, the collateral is the inventory alone.

39. Is flood insurance required if a building and its contents both secure a loan, and the building is located in an SFHA in which flood insurance is available?

Answer: Yes. Flood insurance is required for the building located in the SFHA and any contents stored in that building.

Example: Lender A makes a loan for $200,000 that is secured by a warehouse with an insurable value of $150,000 and inventory in the warehouse worth $100,000. The Act and Regulation require that flood insurance coverage be obtained for the lesser of the outstanding principal balance of the loan or the maximum amount of flood insurance that is available under the NFIP. The maximum amount of insurance that is available for both building and contents is $500,000 for each category. In this situation, Federal flood insurance requirements could be satisfied by placing $150,000 worth of flood insurance coverage on the warehouse, thus insuring it to its insurable value, and $50,000 worth of contents flood insurance coverage on the inventory, thus providing total coverage in the amount of the outstanding principal balance of the loan. Note that this holds true even though the inventory is worth $200,000.

40. If a loan is secured by Building A, which is located in an SFHA, and contents, which are located in Building B, is flood insurance required on the contents securing a loan?

Answer: No. If collateral securing the loan is stored in Building B, which does not secure the loan, then flood insurance is not required on those contents whether or not Building B is located in an SFHA.

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.

42. If a borrower offers a note on a single-family dwelling as collateral for a loan but the lender does not take a security interest in the dwelling itself, is this a designated loan that requires flood insurance?

Answer: No. A designated loan is a loan secured by a building or mobile home. In this example, the lender did not take a security interest in the building; therefore, the loan is not a designated loan.

43. If a lender makes a loan that is not secured by real estate, but is made on the condition of a personal guarantee by a third party who gives the lender a security interest in improved real estate owned by the third party that is located in an SFHA in which flood insurance is available, is it a designated loan that requires flood insurance?

Answer: Yes. The making of a loan on condition of a personal guarantee by a third party and further secured by improved real estate, which is located in

Copyright © 2009 Association of Corporate Counsel

an SFHA, owned by that third party is so closely tied to the making of the loan that it is considered a designated loan that requires flood insurance.

VIII. Flood Insurance Requirements in the Event of the Sale or Transfer of a Designated Loan and/or Its Servicing Rights

44. How do the flood insurance requirements under the Regulation apply to regulated lenders under the following scenarios involving loan servicing?

Scenario 1: A regulated lender originates a designated loan secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act. The regulated lender makes the initial flood determination, provides the borrower with appropriate notice, and flood insurance is obtained. The regulated lender initially services the loan; however, the regulated lender subsequently sells both the loan and the servicing rights to a nonregulated party. What are the regulated lender's requirements under the Regulation? What are the regulated lender's requirements under the Regulation if it only transfers or sells the servicing rights, but retains ownership of the loan?

Answer: The regulated lender must comply with all requirements of the Regulation, including making the initial flood determination, providing appropriate notice to the borrower, and ensuring that the proper amount of insurance is obtained. In the event the regulated lender sells or transfers the loan and servicing rights, the regulated lender must provide notice of the identity of the new servicer to FEMA or its designee. Once the regulated lender has sold the loan and the servicing rights, the lender has no further obligation regarding flood insurance on the loan.

If the regulated lender retains ownership of the loan and only transfers or sells the servicing rights to a nonregulated party, the regulated lender must notify FEMA or its designee of the identity of the new servicer. The servicing contract should require the servicer to comply with all the requirements that are imposed on the regulated lender as owner of the loan, including escrow of insurance premiums and force placement of insurance, if necessary.

Generally, the Regulation does not impose obligations on a loan servicer independent from the obligations it imposes on the owner of a loan. Loan servicers are covered by the escrow, force placement, and flood hazard determination fee provisions of the Act and Regulation primarily so that they may perform the administrative tasks for the regulated lender, without fear of liability to the borrower for the imposition of unauthorized charges. It is the Agencies' longstanding position, as described in the preamble to the Regulation that the obligation of a loan servicer to fulfill administrative duties with respect to the flood insurance requirements arises from the contractual relationship between the loan servicer and the regulated lender or from other commonly accepted standards for performance of servicing obligations. The regulated lender remains ultimately liable for fulfillment of those responsibilities, and must take adequate steps to ensure that the loan servicer will maintain compliance with the flood insurance requirements.

Scenario 2: A nonregulated lender originates a designated loan, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act. The nonregulated lender does not make an initial flood determination or notify the borrower of the need to obtain insurance. The nonregulated lender sells the loan and servicing rights to a regulated lender. What are the regulated lender's requirements under the Regulation? What are the regulated lender's requirements if it only purchases the servicing rights?

Answer: A regulated lender's purchase of a loan and servicing rights, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act, is not an event that triggers any requirements under the Regulation, such as making a new flood determination or requiring a borrower to purchase flood insurance. The Regulation's requirements are triggered when a regulated lender makes, increases, extends, or renews a designated loan. A regulated lender's purchase of a loan does not fall within any of those categories. However, if a regulated lender becomes aware at any point during the life of a designated loan that flood insurance is required, then the regulated lender must comply with the Regulation, including force placing insurance, if necessary. Depending upon the circumstances, safety and soundness considerations may sometimes necessitate that the lender undertake sufficient due diligence upon purchase of a loan as to put the lender on notice of lack of adequate flood insurance. If the purchasing lender subsequently extends, increases, or renews a designated loan, it must also comply with the Act and Regulation.

Where a regulated lender purchases only the servicing rights to a loan originated by a nonregulated lender, the regulated lender is obligated only to follow the terms of its servicing contract with the owner of the loan. In the event the regulated lender subsequently sells or transfers the servicing rights on that loan, the regulated lender must notify FEMA or its designee of the identity of the new servicer, if required to do so by the servicing contract with the owner of the loan.

45. When a regulated lender makes a designated loan and will be servicing that loan, what are the requirements for notifying the Director of FEMA or the Director's designee?

Answer: FEMA stated in a June 4, 1996, letter that the Director's designee is the insurance company issuing the flood insurance policy. The borrower's purchase of a policy (or the regulated lender's force placement of a policy) will constitute notice to FEMA when the regulated lender is servicing that loan.

In the event the servicing is subsequently transferred to a new servicer, the regulated lender must provide notice to the insurance company of the identity of the new servicer no later than 60 days after the effective date of such a change.

46. Would a RESPA Notice of Transfer sent to the Director of FEMA (or the Director's designee) satisfy the regulatory provisions of the Act?

Answer: Yes. The delivery of a copy of the Notice of Transfer or any other form of notice is sufficient if the sender includes, on or with the notice, the following information that FEMA has indicated is needed by its designee:

- Borrower's full name;
- Flood insurance policy number;
- Property address (including city and State);
- Name of lender or servicer making notification;
- Name and address of new servicer; and
- Name and telephone number of contact person at new servicer.

47. Can delivery of the notice be made electronically, including batch transmissions?

Answer: Yes. The Regulation specifically permits transmission by electronic means. A timely batch transmission of the notice would also be permissible, if it is acceptable to the Director's designee.

Copyright © 2009 Association of Corporate Counsel

48. If the loan and its servicing rights are sold by the regulated lender, is the regulated lender required to provide notice to the Director or the Director's designee?

Answer: Yes. Failure to provide such notice would defeat the purpose of the notice requirement because FEMA would have no record of the identity of either the owner or servicer of the loan.

49. Is a regulated lender required to provide notice when the servicer, not the regulated lender, sells or transfers the servicing rights to another servicer?

Answer: No. After servicing rights are sold or transferred, subsequent notification obligations are the responsibility of the new servicer. The obligation of the regulated lender to notify the Director or the Director's designee of the identity of the servicer transfers to the new servicer. The duty to notify the Director or the Director's designee of any subsequent sale or transfer of the servicing rights and responsibilities belongs to that servicer. For example, a financial institution makes and services the loan. It then sells the loan in the secondary market and also sells the servicing rights to a mortgage company. The financial institution notifies the Director's designee of the identity of the new servicer and the other information requested by FEMA so that flood insurance transactions can be properly administered by the Director's designee. If the mortgage company later sells the servicing rights to another firm, the mortgage company, not the financial institution, is responsible for notifying the Director's designee of the identity of the new servicer.

50. In the event of a merger or acquisition of one lending institution with another, what are the responsibilities of the parties for notifying the Director's designee?

Answer: If an institution is acquired by or merges with another institution, the duty to provide notice for the loans being serviced by the acquired institution will fall to the successor institution in the event that notification is not provided by the acquired institution prior to the effective date of the acquisition or merger.

IX. Escrow Requirements

51. Are multi-family buildings or mixed-use properties included in the definition of "residential improved real estate" under the Regulation for which escrows are required?

Answer: "Residential improved real estate" is defined under the Regulation as "real estate upon which a home or other residential building is located or to be located." A loan secured by residential improved real estate located or to be located in an SFHA in which flood insurance is available is a designated loan. Lenders are required to escrow flood insurance premiums and fees for mandatory flood insurance for such loans if the lender requires the escrow of taxes, hazard insurance premiums or any other charges for loans secured by residential improved real estate. A lender is not required to escrow flood insurance premiums and fees for a particular loan if it does not require escrowing of any other charges for that loan.

Multi-family buildings. For the purposes of the Act and the Regulation, the definition of residential improved real estate does not make a distinction between whether a building is single- or multi-family, or whether a building is owner- or renter-occupied. Single-family dwellings (including mobile homes), two-to-four family dwellings, and multi-family properties containing five or more residential units are covered under the Act's escrow provisions. If the building securing the loan meets the Regulation's definition of residential improved real estate and the lender requires the escrow of any other charges such as taxes or hazard insurance premiums, then the lender is required to also escrow premiums and fees for flood insurance.

Mixed-use properties. The lender should look to the primary use of a building to determine whether it meets the definition of "residential improved real estate." (*See* questions and answers 11 and 12 for guidance on residential and nonresidential buildings.) If the primary use of a mixed-use property is for residential purposes, the Regulation's escrow requirements apply.

52. When must escrow accounts be established for flood insurance purposes?

Answer: If a lender requires the escrow of taxes, insurance premiums, fees, or any other charges for a loan secured by *residential* improved real estate or a mobile home, the lender must also require the escrow of all flood insurance premiums and fees. When administering loans secured by one-to-four family dwellings, lenders should look to the definition of "Federally related mortgage loan" contained in the Real Estate Settlement Procedures Act (RESPA) to see whether a particular loan is subject to the escrow requirements in Section 10 of RESPA. (This includes individual units of condominiums. Individual units of cooperatives, although covered by Section 10 of RESPA, are not insurable under the NFIP and are not covered by the Regulation.) Loans on multi-family dwellings with five or more units are not covered by RESPA requirements. Pursuant to the Regulation, however, lenders must escrow premiums and fees for any required flood insurance if the lender requires escrows for other purposes, such as hazard insurance or taxes.

53. Do voluntary escrow accounts established at the request of the borrower trigger a requirement for the lender to escrow premiums for required flood insurance?

Answer: No. If escrow accounts for other purposes are established at the voluntary request of the borrower, the lender is not required to establish escrow accounts for flood insurance premiums. Examiners should review the loan policies of the lender and the underlying legal obligation between the parties to the loan to determine whether the accounts are, in fact, voluntary. For example, when a lender's loan policies require borrowers to establish escrow accounts for other purposes and the contractual obligation permits the lender to establish escrow accounts for those other purposes, the lender will have the burden of demonstrating that an existing escrow was made pursuant to a voluntary request by the borrower.

54. Will premiums paid for credit life insurance, disability insurance, or similar insurance programs be viewed as escrow accounts requiring the escrow of flood insurance premiums?

Answer: No. Premiums paid for these types of insurance policies will not trigger the escrow requirement for flood insurance premiums.

55. Will escrow-type accounts for commercial loans, secured by multi-family residential buildings, trigger the escrow requirement for flood insurance premiums?

Answer: It depends. Escrow-type accounts established in connection with the underlying agreement between the buyer and seller, or that relate to the commercial venture itself, such as "interest reserve accounts," "compensating balance accounts," "marketing accounts," and similar accounts are not the type of accounts that constitute escrow accounts for the purpose of the Regulation. However, escrow accounts established for the protection of the property, such as escrows for hazard insurance premiums or local real estate taxes, are the types of escrow accounts that trigger the

Copyright © 2009 Association of Corporate Counsel

requirement to escrow flood insurance premiums.

56. Which requirements for escrow accounts apply to properties adequately covered by RCBAPs?

Answer: RCBAPs (Residential Condominium Building Association Policies) are policies purchased by the condominium association on behalf of itself and the individual unit owners in the condominium. A portion of the periodic dues paid to the association by the condominium owners applies to the premiums on the policy. When a lender makes, increases, renews, or extends a loan secured by a condominium unit that is adequately covered by an RCBAP and dues to the condominium association apply to the RCBAP premiums, an escrow account is not required. However, if the RCBAP coverage is inadequate and the unit is also covered by a dwelling form policy, premiums for the dwelling form policy would need to be escrowed if the lender requires escrow for other purposes, such as hazard insurance or taxes. Lenders should exercise due diligence with respect to continuing compliance with the insurance requirements on the part of the condominium association.

X. Force Placement of Flood Insurance

57. What is the requirement for the force placement of flood insurance under the Act and Regulation?

Answer: The Act and Regulation require a lender to force place flood insurance, if all of the following circumstances occur:

- The lender determines at any time during the life of the loan that the property securing the loan is located in an SFHA;
- Flood insurance under the Act is available for improved property securing the loan;
- The lender determines that flood insurance coverage is inadequate or does not exist; and
- After required notice, the borrower fails to purchase the appropriate amount of coverage.

The Act and Regulation require the lender, or its servicer, to send notice to the borrower upon making a determination that the improved real estate collateral's insurance coverage has expired or is less than the amount required for that particular property, such as upon receipt of the notice of cancellation or expiration from the insurance provider. The notice to the borrower must also state that if the borrower does not obtain the insurance within the 45-day period, the lender will purchase the insurance on behalf of the borrower and may charge the borrower for the cost of premiums and fees to obtain the coverage. The Act does not permit a lender or its servicer to send the required 45-day notice to the borrower prior to making a determination that flood insurance coverage is inadequate. If adequate insurance is not obtained by the borrower within the 45-day notice period, then the lender must purchase insurance on the borrower's behalf. Standard Fannie Mae/Freddie Mac documents permit the servicer or lender to add those charges to the principal amount of the loan.

FEMA developed the Mortgage Portfolio Protection Program (MPPP) to assist lenders in connection with force placement procedures. FEMA published these procedures in the **Federal Register** on August 29, 1995 (60 FR 44881). Appendix A of FEMA's September 2007 *Mandatory Purchase of Flood Insurance Guidelines* sets out the MPPP Guidelines and Requirements, including force placement procedures and examples of notification letters to be used in connection with the MPPP.

58. Can a servicer force place on behalf of a lender?

Answer: Yes. Assuming the statutory prerequisites for force placement are met, and subject to the servicing contract between the lender and the servicer, the Act clearly authorizes servicers to force place flood insurance on behalf of the lender, following the procedures set forth in the Regulation.

59. When force placement occurs, what is the amount of insurance required to be placed?

Answer: The amount of flood insurance coverage required is the same regardless of how the insurance is placed. (*See* Section II. Determining the appropriate amount of flood insurance required under the Act and Regulation and also Section VII. Flood Insurance Requirements for Home Equity Loans, Lines of Credit, Subordinate Liens, and Other Security Interests in Collateral Located in an SFHA.)

60. Can the 45-day notice period be accelerated by sending notice to the borrower prior to the actual date of expiration of flood insurance coverage?

Answer: [Reserved]

61. Is a reasonable period of time allowed after the end of the 45-day notice period for a lender or its servicer to implement force placement?

Answer: [*Reserved*]

62. Does a lender or its servicer have the authority to charge a borrower for the cost of insurance coverage during the 45-day notice period?

Answer: [Reserved]

XI. Private Insurance Policies

63. May a lender rely on a private insurance policy to meet its obligation to ensure that its designated loans are covered by an adequate amount of flood insurance?

Answer: It depends. A private insurance policy may be an adequate substitute for NFIP insurance if it meets the criteria set forth by FEMA in its *Mandatory Purchase of Flood Insurance Guidelines.* Similarly, a private insurance policy may be used to supplement NFIP insurance for designated loans where the property is underinsured if it meets the criteria set forth by FEMA in its *Mandatory Purchase of Flood Insurance Guidelines.* FEMA states that, to the extent that a private policy differs from the NFIP Standard Flood Insurance Policy, the differences should be carefully examined before the policy is accepted as sufficient protection under the law. FEMA also states that the suitability of private policies need only be considered when the mandatory purchase requirement applies.

64. When may a lender rely on a private insurance policy that does not meet the criteria set forth by FEMA?

Answer: A lender may rely on a private insurance policy that does not meet the criteria set forth by FEMA only in limited circumstances. For example, when a flood insurance policy has expired and the borrower has failed to renew coverage, private insurance policies that do not meet the criteria set forth by FEMA, such as private insurance policies providing portfolio-wide blanket coverage, may be useful protection for the lender for a gap in coverage in the period of time before a force placed policy takes effect. However, the lender must still force place adequate coverage in a timely manner, as required, and may not rely on a private insurance policy that does not meet the criteria set forth by FEMA on an ongoing basis.

XII. Required Use of Standard Flood Hazard Determination Form (SFHDF)

65. Does the SFHDF replace the borrower notification form?

Answer: No. The SFHDF is used by the lender to determine whether the building or mobile home offered as collateral security for a loan is or will be located in an SFHA in which flood

Copyright © 2009 Association of Corporate Counsel

insurance is available under the Act. The notification form, on the other hand, is used to notify the borrower(s) that the building or mobile home is or will be located in an SFHA and to inform them about flood insurance requirements and the availability of Federal disaster relief assistance.

66. May a lender provide the SFHDF to the borrower?

Answer: Yes. While not a statutory requirement, a lender may provide a copy of the flood determination to the borrower so the borrower can provide it to the insurance agent in order to minimize flood zone discrepancies between the lender's determination and the borrower's policy. A lender would also need to make the determination available to the borrower in case of a special flood hazard determination review, which must be requested jointly by the lender and the borrower. In the event a lender provides the SFHDF to the borrower, the signature of the borrower is not required to acknowledge receipt of the form.

67. May the SFHDF be used in electronic format?

Answer: Yes. In the final rule adopting the SFHDF, FEMA stated: ''If an electronic format is used, the format and exact layout of the Standard Flood Hazard Determination Form is not required, but the fields and elements listed on the form are required. Any electronic format used by lenders must contain all mandatory fields indicated on the form.'' It should be noted, however, that the lender must be able to reproduce the form upon receiving a document request by its Federal supervisory agency.

68. May a lender rely on a previous determination for a refinancing or assumption of a loan or multiple loans to the same borrower secured by the same property?

Answer: It depends. Section 528 of the Act, 42 U.S.C. 4104b(e), permits a lender to rely on a previous flood determination using the SFHDF when it is increasing, extending, renewing, or purchasing a loan secured by a building or a mobile home. Under the Act, the ''making'' of a loan is not listed as a permissible event that permits a lender to rely on a previous determination. When the loan involves a refinancing or assumption by the same lender who obtained the original flood determination on the same property, the lender may rely on the previous determination only if the original determination was made not more than seven years before the date of the transaction, the basis for the determination was set forth on the SFHDF, and there were no map revisions or updates affecting the security property since the original determination was made. A loan refinancing or assumption made by a lender different from the one who obtained the original determination constitutes a new loan, thereby requiring a new determination. Further, if the same lender makes multiple loans to the same borrower secured by the same improved real estate, the lender may rely on its previous determination if the original determination was made not more than seven years before the date of the transaction, the basis for the determination was set forth on the SFHDF, and there were no map revisions or updates affecting the security property since the original determination was made.

XIII. Flood Determination Fees

69. When can lenders or servicers charge the borrower a fee for making a determination?

Answer: There are four instances under the Act and Regulation when the borrower can be charged a specific fee for a flood determination:

- When the determination is made in connection with the making, increasing, extending, or renewing of a loan that is initiated by the borrower;
- When the determination is prompted by a revision or updating by FEMA of floodplain areas or flood-risk zones;
- When the determination is prompted by FEMA's publication of notices or compendia that affect the area in which the security property is located; or
- When the determination results in force placement of insurance.

Loan or other contractual documents between the parties may also permit the imposition of fees.

70. May charges made for life-of-loan reviews by flood determination firms be passed along to the borrower?

Answer: Yes. In addition to the initial determination at the time a loan is made, increased, renewed, or extended, many flood determination firms provide a service to the lender to review and report changes in the flood status of a dwelling for the entire term of the loan. The fee charged for the service at loan closing is a composite one for conducting both the original and subsequent reviews. Charging a fee for the original determination is clearly within the permissible purpose envisioned by the Act. The Agencies agree that a determination fee may include, among other things, reasonable fees for a lender, servicer, or third party to monitor the flood hazard status of property securing a loan in order to make determinations on an ongoing basis.

However, the life-of-loan fee is based on the authority to charge a determination fee and, therefore, the monitoring fee may be charged only if the events specified in the answer to Question 69 occur. Further, a lender may not charge a composite determination and life-of-loan fee if the loan does not close, because the life-of-loan fee would be an unearned fee in violation of the Real Estate Settlement Procedures Act.

XIV. Flood Zone Discrepancies

71. What should a lender do when there is a discrepancy between the flood hazard zone designation on the flood determination form and the flood insurance policy?

A lender should only be concerned about a discrepancy on the Standard Flood Hazard Determination Form (the SFHDF) and the one on the flood insurance policy if the discrepancy is between a high-risk zone (A or V) and a low- or moderate-risk zone (B, C, D, or X). In other words, a lender need not be concerned about subcategory differences between flood zones on these two documents. Once in possession of a copy of the flood insurance policy, a lender should systematically compare the flood zone designation on the policy with the zone shown on the SFHDF. If the flood insurance policy shows a lower risk zone than the SFHDF, then lender should investigate. As noted in FEMA's *Mandatory Purchase of Flood Insurance Guidelines,* Federal law sets the ultimate responsibility to place flood insurance on the lender, with limited reliance permitted on third parties to the extent that the information that those third parties provide is guaranteed.

A lender should first determine whether the difference results from the application of the NFIP's ''Grandfather Rule.'' This rule provides for the continued use of a rating on an insured property when the initial flood insurance policy was issued prior to changes in the hazard rating for the particular flood zone where the property is located. The Grandfather Rule allows policyholders who have maintained continuous coverage and/or who have built in compliance with the Flood Insurance Rate Map to continue to benefit from the prior, more favorable

rating for particular pieces of improved property. A discrepancy resulting from application of the NFIP's Grandfather Rule is reasonable and acceptable, but the lender should substantiate these findings.

A lender should also determine whether a difference in flood zone designations is the result of a mistake. To do so, a lender should facilitate communication between itself or the third-party service provider that performed the flood hazard determination for the lender. If it appears that the discrepancy is the result of a mistake, a lender should recheck its determination. If there still appears to be a discrepancy after this step has been taken, a lender and borrower may jointly request that FEMA review the determination to confirm or review the accuracy of the original determination performed by a lender or on the lender's behalf. However, FEMA will only conduct this review if the request is submitted within 45 days of the date the lender notified the borrower that a building or manufactured home is in an SFHA and flood insurance is required.

If, despite these efforts, the discrepancy is not resolved, or in the course of attempting to resolve a discrepancy, a borrower or an insurance company or its agent is uncooperative in assisting a lender in this attempt, the lender should notify the insurance agent about the insurer's duty pursuant to FEMA's letter of April 16, 2008 (W–08021), to write a flood insurance policy that covers the most hazardous flood zone. When providing this notification, the lender should include its zone information and it should also notify the insurance company itself. The lender should substantiate these communications in its loan file.

72. Can a lender be found in violation of the requirements of the Regulation if, despite the lender's diligence in making the flood hazard determination, notifying the borrower of the risk of flood and the need to obtain flood insurance, and requiring mandatory flood insurance, there is a discrepancy between the flood hazard zone designation on the flood determination form and the flood insurance policy?

Answer: As noted in question and answer 71 above, lenders should have a process in place to identify and resolve flood zone discrepancies. A lender is in the best position to coordinate between the various parties involved in a mortgage loan transaction to resolve any flood zone discrepancy. If a lender is able to substantiate in its loan file a *bona fide* effort to resolve a discrepancy, either by finding a legitimate reason for such discrepancy or by attempting to resolve the discrepancy, for example, by contacting FEMA to review the determination, no violation will be cited. If a pattern or practice of unresolved discrepancies is found in a lender's loan portfolio due to a lack of effort on the lender's part to resolve such discrepancies, the Agencies may cite the lender for a violation of the mandatory purchase requirements.

XV. Notice of Special Flood Hazards and Availability of Federal Disaster Relief

73. Does the notice have to be provided to each borrower for a real estate related loan?

Answer: No. In a transaction involving multiple borrowers, the lender need only provide the notice to any one of the borrowers in the transaction. Lenders may provide multiple notices if they choose. The lender and borrower(s) typically designate the borrower to whom the notice will be provided. The notice must be provided to a borrower when the lender determines that the property securing the loan is or will be located in an SFHA.

74. Lenders making loans on mobile homes may not always know where the home is to be located until just prior to, or sometimes after, the time of loan closing. How is the notice requirement applied in these situations?

Answer: When it is not reasonably feasible to give notice before the completion of the transaction, the notice requirement can be met by lenders in mobile home loan transactions if notice is provided to the borrower as soon as practicable after determination that the mobile home will be located in an SFHA. Whenever time constraints can be anticipated, regulated lenders should use their best efforts to provide adequate notice of flood hazards to borrowers at the earliest possible time. In the case of loan transactions secured by mobile homes not located on a permanent foundation, the Agencies note that such "home only" transactions are excluded from the definition of mobile home and the notice requirements would not apply to these transactions.

However, as indicated in the preamble to the Regulation, the Agencies encourage a lender to advise the borrower that if the mobile home is later located on a permanent foundation in an SFHA, flood insurance will be required. If the lender, when notified of the location of the mobile home subsequent to the loan closing, determines that it has been placed on a permanent foundation and is located in an SFHA in which flood insurance is available under the Act, flood insurance coverage becomes mandatory and appropriate notice must be given to the borrower under those provisions. If the borrower fails to purchase flood insurance coverage within 45 days after notification, the lender must force place the insurance.

75. When is the lender required to provide notice to the servicer of a loan that flood insurance is required?

Answer: Because the servicer of a loan is often not identified prior to the closing of a loan, the Regulation requires that notice be provided no later than the time the lender transmits other loan data, such as information concerning hazard insurance and taxes, to the servicer.

76. What will constitute appropriate form of notice to the servicer?

Answer: Delivery to the servicer of a copy of the notice given to the borrower is appropriate notice. The Regulation also provides that the notice can be made either electronically or by a written copy.

77. In the case of a servicer affiliated with the lender, is it necessary to provide the notice?

Answer: Yes. The Act requires the lender to notify the servicer of special flood hazards and the Regulation reflects this requirement. Neither contains an exception for affiliates.

78. How long does the lender have to maintain the record of receipt by the borrower of the notice?

Answer: The record of receipt provided by the borrower must be maintained for the time that the lender owns the loan. Lenders may keep the record in the form that best suits the lender's business practices. Lenders may retain the record electronically, but they must be able to retrieve the record within a reasonable time pursuant to a document request from their Federal supervisory agency.

79. Can a lender rely on a previous notice if it is less than seven years old, and it is the same property, same borrower, and same lender?

Answer: No. The preamble to the Regulation states that subsequent transactions by the same lender with respect to the same property will be treated as a renewal and will require no new determination. However, neither the Regulation nor the preamble addresses waiving the requirement to provide the notice to the borrower.

Copyright © 2009 Association of Corporate Counsel

Therefore, the lender must provide a new notice to the borrower, even if a new determination is not required.

80. Is use of the sample form of notice mandatory?

Answer: No. Although lenders are required to provide a notice to a borrower when it makes, increases, extends, or renews a loan secured by an improved structure located in an SFHA, use of the sample form of notice provided in Appendix A of the Regulation or in Appendix 4 of FEMA's *Mandatory Purchase of Flood Insurance Guidelines* is not mandatory. It should be noted that the sample form includes other information in addition to what is required by the Act and the Regulation. Lenders may personalize, change the format of, and add information to the sample form of notice, if they choose. However, a lender-revised notice must provide the borrower with at least the minimum information required by the Act and Regulation. Therefore, lenders should consult the Act and Regulation to determine the information needed.

XVI. Mandatory Civil Money Penalties

81. Which violations of the Act can result in a mandatory civil money penalty?

Answer: A pattern or practice of violations of any of the following requirements of the Act and their implementing Regulation triggers a mandatory civil money penalty:

- Purchase of flood insurance where available (42 U.S.C. 4012a(b));
- Escrow of flood insurance premiums (42 U.S.C. 4012a(d));
- Force placement of flood insurance (42 U.S.C. 4012a(e));
- Notice of special flood hazards and the availability of Federal disaster relief assistance (42 U.S.C. 4104a(a)); and
- Notice of servicer and any change of servicer (42 U.S.C. 4101a(b)).

The Act states that any regulated lending institution found to have a pattern or practice of certain violations ''shall be assessed a civil penalty'' by its Federal supervisor in an amount not to exceed $350 per violation, with a ceiling per institution of $100,000 during any calendar year (42 U.S.C. 4012a(f)(5)). Each Agency adjusts these limits pursuant to the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, 28 U.S.C. 2461 note.[13] Lenders pay the penalties into the National Flood Mitigation Fund held by the Department of the Treasury for the benefit of FEMA.

82. What constitutes a ''pattern or practice'' of violations for which civil money penalties must be imposed under the Act?

Answer: The Act does not define ''pattern or practice.'' The Agencies make a determination of whether a pattern or practice exists by weighing the individual facts and circumstances of each case. In making the determination, the Agencies look both to guidance and experience with determinations of pattern or practice under other regulations (such as Regulation B (Equal Credit Opportunity) and Regulation Z (Truth in Lending)), as well as Agencies' precedents in assessing civil money penalties for flood insurance violations.

The *Policy Statement on Discrimination in Lending* (Policy Statement) provided the following guidance on what constitutes a pattern or practice:

> Isolated, unrelated, or accidental occurrences will not constitute a pattern or practice. However, repeated, intentional, regular, usual, deliberate, or institutionalized practices will almost always constitute a pattern or practice. The totality of the circumstances must be considered when assessing whether a pattern or practice is present.

In determining whether a financial institution has engaged in a pattern or practice of flood insurance violations, the Agencies' considerations may include, but are not limited to, the presence of one or more of the following factors:

- Whether the conduct resulted from a common cause or source within the financial institution's control;
- Whether the conduct appears to be grounded in a written or unwritten policy or established practice;
- Whether the noncompliance occurred over an extended period of time;
- The relationship of the instances of noncompliance to one another (for example, whether the instances of noncompliance occurred in the same area of a financial institution's operations);
- Whether the number of instances of noncompliance is significant relative to the total number of applicable transactions. (Depending on the circumstances, however, violations that involve only a small percentage of an institution's total activity could constitute a pattern or practice);
- Whether a financial institution was cited for violations of the Act and Regulation at prior examinations and the steps taken by the financial institution to correct the identified deficiencies;
- Whether a financial institution's internal and/or external audit process had not identified and addressed deficiencies in its flood insurance compliance; and
- Whether the financial institution lacks generally effective flood insurance compliance policies and procedures and/or a training program for its employees.

Although these guidelines and considerations are not dispositive of a final resolution, they do serve as a reference point in assessing whether there may be a pattern or practice of violations of the Act and Regulation in a particular case. As previously stated, the presence or absence of one or more of these considerations may not eliminate a finding that a pattern or practice exists.

End of text of the Interagency Questions and Answers Regarding Flood Insurance.

Dated: May 15, 2009.

John C. Dugan,

Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, July 14, 2009.

Jennifer J. Johnson,

Secretary of the Board.

Dated at Washington, DC, this 8th day of July, 2009.

Robert E. Feldman,

Executive Secretary, Federal Deposit Insurance Corporation.

Dated: April 2, 2009.

By the Office of Thrift Supervision.

John E. Bowman,

Acting Director.

Date: July 8, 2009

Roland E. Smith,

Secretary, Farm Credit Administration Board.

By the National Credit Union Administration Board, on June 5, 2009.

Mary F. Rupp,

Secretary of the Board.

[FR Doc. E9–17129 Filed 7–20–09; 8:45 am]

BILLING CODE 4810–33–P; 6210–01–P; 6714–01–P; 6720–01–P; 6705–01–P; 7535–01–P

[13] Please refer to 12 CFR 19.240(a) (OCC); 12 CFR 263.65(b)(10) (Board); 12 CFR 308.132(c)(xvi) (FDIC); 12 CFR 509.103(c) (OTS); 12 CFR 622.61(b) (FCA); and 12 CFR 747.1001(a) (NCUA) for the Agencies' current civil penalty limits.

Copyright © 2009 Association of Corporate Counsel

Fair Credit Reporting Act – 15 USC 1681m(e)

Identity Theft Red Flag Regulations – Subpart J to Regulation V

Copyright © 2009 Association of Corporate Counsel

Office of the Law Revision Counsel, U.S. House of Representatives
Home Search Download Classification Codification Popular Names About

Go to 1st query term(s)

-CITE-

15 USC Sec. 1681m 01/08/2008

-EXPCITE-

TITLE 15 - COMMERCE AND TRADE

CHAPTER 41 - CONSUMER CREDIT PROTECTION

SUBCHAPTER III - CREDIT REPORTING AGENCIES

Red Flag Guidelines
§1681m(e)

-HEAD-

Sec. 1681m. Requirements on users of consumer reports

-STATUTE-

(**a**) Duties of users taking adverse actions on basis of information contained in consumer reports

If any person takes any adverse action with respect to any consumer that is based in whole or in part on any information contained in **a** consumer report, the person shall -

(1) provide oral, written, or electronic notice of the adverse action to the consumer;

(2) provide to the consumer orally, in writing, or electronically -

(**A**) the name, address, and telephone number of the consumer reporting agency (including **a** toll-free telephone number established by the agency if the agency compiles and maintains files on consumers on **a** nationwide basis) that furnished the report to the person; and

(B) **a** statement that the consumer reporting agency did not make the decision to take the adverse action and is unable to provide the consumer the specific reasons why the adverse

Copyright © 2009 Association of Corporate Counsel

action was taken; and

(3) provide to the consumer an oral, written, or electronic notice of the consumer's right -

(A) to obtain, under section 1681j of this title, a free copy of a consumer report on the consumer from the consumer reporting agency referred to in paragraph (2), which notice shall include an indication of the 60-day period under that section for obtaining such a copy; and

(B) to dispute, under section 1681i of this title, with a consumer reporting agency the accuracy or completeness of any information in a consumer report furnished by the agency.

(b) Adverse action based on information obtained from third parties other than consumer reporting agencies

(1) In general

Whenever credit for personal, family, or household purposes involving a consumer is denied or the charge for such credit is increased either wholly or partly because of information obtained from a person other than a consumer reporting agency bearing upon the consumer's credit worthiness,(!1) credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living, the user of such information shall, within a reasonable period of time, upon the consumer's written request for the reasons for such adverse action received within sixty days after learning of such adverse action, disclose the nature of the information to the consumer. The user of such information shall clearly and accurately disclose to the consumer his right to make such written request at the time such adverse action is communicated to the consumer.

(2) Duties of person taking certain actions based on information

Copyright © 2009 Association of Corporate Counsel

provided by affiliate

(A) Duties, generally

If a person takes an action described in subparagraph (B) with respect to a consumer, based in whole or in part on information described in subparagraph (C), the person shall -

(i) notify the consumer of the action, including a statement that the consumer may obtain the information in accordance with clause (ii); and

(ii) upon a written request from the consumer received within 60 days after transmittal of the notice required by clause (i), disclose to the consumer the nature of the information upon which the action is based by not later than 30 days after receipt of the request.

(B) Action described

An action referred to in subparagraph (A) is an adverse action described in section 1681a(k)(1)(A) of this title, taken in connection with a transaction initiated by the consumer, or any adverse action described in clause (i) or (ii) of section 1681a(k)(1)(B) of this title.

(C) Information described

Information referred to in subparagraph (A) -

(i) except as provided in clause (ii), is information that -

(I) is furnished to the person taking the action by a person related by common ownership or affiliated by common corporate control to the person taking the action; and

(II) bears on the credit worthiness,(!1) credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living of the consumer; and

(ii) does not include -

(I) information solely as to transactions or experiences

Copyright © 2009 Association of Corporate Counsel

between the consumer and the person furnishing the information; or

(II) information in a consumer report.

(c) Reasonable procedures to assure compliance

No person shall be held liable for any violation of this section if he shows by a preponderance of the evidence that at the time of the alleged violation he maintained reasonable procedures to assure compliance with the provisions of this section.

(d) Duties of users making written credit or insurance solicitations on basis of information contained in consumer files

(1) In general

Any person who uses a consumer report on any consumer in connection with any credit or insurance transaction that is not initiated by the consumer, that is provided to that person under section 1681b(c)(1)(B) of this title, shall provide with each written solicitation made to the consumer regarding the transaction a clear and conspicuous statement that -

(A) information contained in the consumer's consumer report was used in connection with the transaction;

(B) the consumer received the offer of credit or insurance because the consumer satisfied the criteria for credit worthiness (!2) or insurability under which the consumer was selected for the offer;

(C) if applicable, the credit or insurance may not be extended if, after the consumer responds to the offer, the consumer does not meet the criteria used to select the consumer for the offer or any applicable criteria bearing on credit worthiness (!2) or insurability or does not furnish any required collateral;

(D) the consumer has a right to prohibit information

Copyright © 2009 Association of Corporate Counsel

contained in the consumer's file with any consumer reporting agency from being used in connection with any credit or insurance transaction that is not initiated by the consumer; and

(E) the consumer may exercise the right referred to in subparagraph (D) by notifying a notification system established under section 1681b(e) of this title.

(2) Disclosure of address and telephone number; format

A statement under paragraph (1) shall -

(A) include the address and toll-free telephone number of the appropriate notification system established under section 1681b(e) of this title; and

(B) be presented in such format and in such type size and manner as to be simple and easy to understand, as established by the Commission, by rule, in consultation with the Federal banking agencies and the National Credit Union Administration.

(3) Maintaining criteria on file

A person who makes an offer of credit or insurance to a consumer under a credit or insurance transaction described in paragraph (1) shall maintain on file the criteria used to select the consumer to receive the offer, all criteria bearing on credit worthiness (!2) or insurability, as applicable, that are the basis for determining whether or not to extend credit or insurance pursuant to the offer, and any requirement for the furnishing of collateral as a condition of the extension of credit or insurance, until the expiration of the 3-year period beginning on the date on which the offer is made to the consumer.

(4) Authority of Federal agencies regarding unfair or deceptive acts or practices not affected

This section is not intended to affect the authority of any

Copyright © 2009 Association of Corporate Counsel

Federal or State agency to enforce a prohibition against unfair or deceptive acts or practices, including the making of false or misleading statements in connection with a credit or insurance transaction that is not initiated by the consumer.

* (e) Red flag guidelines and regulations required

(1) Guidelines

The Federal banking agencies, the National Credit Union Administration, and the Commission shall jointly, with respect to the entities that are subject to their respective enforcement authority under section 1681s of this title -

(A) establish and maintain guidelines for use by each financial institution and each creditor regarding identity theft with respect to account holders at, or customers of, such entities, and update such guidelines as often as necessary;

(B) prescribe regulations requiring each financial institution and each creditor to establish reasonable policies and procedures for implementing the guidelines established pursuant to subparagraph (A), to identify possible risks to account holders or customers or to the safety and soundness of the institution or customers; and

(C) prescribe regulations applicable to card issuers to ensure that, if a card issuer receives notification of a change of address for an existing account, and within a short period of time (during at least the first 30 days after such notification is received) receives a request for an additional or replacement card for the same account, the card issuer may not issue the additional or replacement card, unless the card issuer, in accordance with reasonable policies and procedures -

(i) notifies the cardholder of the request at the former address of the cardholder and provides to the cardholder a

Copyright © 2009 Association of Corporate Counsel

means of promptly reporting incorrect address changes;

(ii) notifies the cardholder of the request by such other means of communication as the cardholder and the card issuer previously agreed to; or

(iii) uses other means of assessing the validity of the change of address, in accordance with reasonable policies and procedures established by the card issuer in accordance with the regulations prescribed under subparagraph (B).

(2) Criteria

(A) In general

In developing the guidelines required by paragraph (1)(A), the agencies described in paragraph (1) shall identify patterns, practices, and specific forms of activity that indicate the possible existence of identity theft.

(B) Inactive accounts

In developing the guidelines required by paragraph (1)(A), the agencies described in paragraph (1) shall consider including reasonable guidelines providing that when a transaction occurs with respect to a credit or deposit account that has been inactive for more than 2 years, the creditor or financial institution shall follow reasonable policies and procedures that provide for notice to be given to a consumer in a manner reasonably designed to reduce the likelihood of identity theft with respect to such account.

(3) Consistency with verification requirements

Guidelines established pursuant to paragraph (1) shall not be inconsistent with the policies and procedures required under section 5318(l) of title 31.

(f) Prohibition on sale or transfer of debt caused by identity theft

Copyright © 2009 Association of Corporate Counsel

(1) In general

No person shall sell, transfer for consideration, or place for collection a debt that such person has been notified under section 1681c-2 of this title has resulted from identity theft.

(2) Applicability

The prohibitions of this subsection shall apply to all persons collecting a debt described in paragraph (1) after the date of a notification under paragraph (1).

(3) Rule of construction

Nothing in this subsection shall be construed to prohibit -

(A) the repurchase of a debt in any case in which the assignee of the debt requires such repurchase because the debt has resulted from identity theft;

(B) the securitization of a debt or the pledging of a portfolio of debt as collateral in connection with a borrowing; or

(C) the transfer of debt as a result of a merger, acquisition, purchase and assumption transaction, or transfer of substantially all of the assets of an entity.

(g) Debt collector communications concerning identity theft

If a person acting as a debt collector (as that term is defined in subchapter V of this chapter) on behalf of a third party that is a creditor or other user of a consumer report is notified that any information relating to a debt that the person is attempting to collect may be fraudulent or may be the result of identity theft, that person shall -

(1) notify the third party that the information may be fraudulent or may be the result of identity theft; and

(2) upon request of the consumer to whom the debt purportedly relates, provide to the consumer all information to which the

Copyright © 2009 Association of Corporate Counsel

consumer would otherwise be entitled if the consumer were not a victim of identity theft, but wished to dispute the debt under provisions of law applicable to that person.

(h) Duties of users in certain credit transactions

(1) In general

Subject to rules prescribed as provided in paragraph (6), if any person uses a consumer report in connection with an application for, or a grant, extension, or other provision of, credit on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through that person, based in whole or in part on a consumer report, the person shall provide an oral, written, or electronic notice to the consumer in the form and manner required by regulations prescribed in accordance with this subsection.

(2) Timing

The notice required under paragraph (1) may be provided at the time of an application for, or a grant, extension, or other provision of, credit or the time of communication of an approval of an application for, or grant, extension, or other provision of, credit, except as provided in the regulations prescribed under paragraph (6).

(3) Exceptions

No notice shall be required from a person under this subsection if -

(A) the consumer applied for specific material terms and was granted those terms, unless those terms were initially specified by the person after the transaction was initiated by the consumer and after the person obtained a consumer report; or

Copyright © 2009 Association of Corporate Counsel

(B) the person has provided or will provide a notice to the consumer under subsection (a) of this section in connection with the transaction.

(4) Other notice not sufficient

A person that is required to provide a notice under subsection (a) of this section cannot meet that requirement by providing a notice under this subsection.

(5) Content and delivery of notice

A notice under this subsection shall, at a minimum -

(A) include a statement informing the consumer that the terms offered to the consumer are set based on information from a consumer report;

(B) identify the consumer reporting agency furnishing the report;

(C) include a statement informing the consumer that the consumer may obtain a copy of a consumer report from that consumer reporting agency without charge; and

(D) include the contact information specified by that consumer reporting agency for obtaining such consumer reports (including a toll-free telephone number established by the agency in the case of a consumer reporting agency described in section 1681a(p) of this title).

(6) Rulemaking

(A) Rules required

The Commission and the Board shall jointly prescribe rules.

(B) Content

Rules required by subparagraph (A) shall address, but are not limited to -

(i) the form, content, time, and manner of delivery of any notice under this subsection;

Copyright © 2009 Association of Corporate Counsel

(ii) clarification of the meaning of terms used in this subsection, including what credit terms are material, and when credit terms are materially less favorable;

(iii) exceptions to the notice requirement under this subsection for classes of persons or transactions regarding which the agencies determine that notice would not significantly benefit consumers;

(iv) a model notice that may be used to comply with this subsection; and

(v) the timing of the notice required under paragraph (1), including the circumstances under which the notice must be provided after the terms offered to the consumer were set based on information from a consumer report.

(7) Compliance

A person shall not be liable for failure to perform the duties required by this section if, at the time of the failure, the person maintained reasonable policies and procedures to comply with this section.

(8) Enforcement

(A) No civil actions

Sections 1681n and 1681o of this title shall not apply to any failure by any person to comply with this section.

(B) Administrative enforcement

This section shall be enforced exclusively under section 1681s of this title by the Federal agencies and officials identified in that section.

-SOURCE-

(Pub. L. 90-321, title VI, Sec. 615, as added Pub. L. 91-508, title VI, Sec. 601, Oct. 26, 1970, 84 Stat. 1133; amended Pub. L. 104-208, div. A, title II, Sec. 2411, Sept. 30, 1996, 110 Stat. 3009-

Copyright © 2009 Association of Corporate Counsel

443; Pub. L. 108-159, title I, Secs. 114, 154(b), 155, title II, Sec. 213(a), title III, Sec. 311(a), title VIII, Sec. 811(h), Dec. 4, 2003, 117 Stat. 1960, 1967, 1978, 1988, 2012.)

-MISC1-

AMENDMENTS

2003 - Subsec. (d)(2). Pub. L. 108-159, Sec. 213(a), amended heading and text of par. (2) generally. Prior to amendment, text read as follows: "A statement under paragraph (1) shall include the address and toll-free telephone number of the appropriate notification system established under section 1681b(e) of this title."

Subsec. (e). Pub. L. 108-159, Sec. 811(h), repealed Pub. L. 104-208, Sec. 2411(c). See 1996 Amendment note below.

Pub. L. 108-159, Sec. 114, added subsec. (e) and struck out former subsec. (e) designation that had been added with no heading or text by Pub. L. 104-208, Sec. 2411(c). See note above and 1996 Amendment note below.

Subsec. (f). Pub. L. 108-159, Sec. 154(b), added subsec. (f).

Subsec. (g). Pub. L. 108-159, Sec. 155, added subsec. (g).

Subsec. (h). Pub. L. 108-159, Sec. 311(a), added subsec. (h).

1996 - Subsec. (a). Pub. L. 104-208, Sec. 2411(a), inserted heading and amended text of subsec. (a) generally. Prior to amendment, text read as follows: "Whenever credit or insurance for personal, family, or household purposes, or employment involving a consumer is denied or the charge for such credit or insurance is increased either wholly or partly because of information contained in a consumer report from a consumer reporting agency, the user of the consumer report shall so advise the consumer against whom such adverse action has been taken and supply the name and address of the consumer reporting agency making the report."

Copyright © 2009 Association of Corporate Counsel

Subsec. (b). Pub. L. 104-208, Sec. 2411(e), inserted subsec. heading, designated existing provisions as par. (1) and inserted heading, and added par. (2).

Subsec. (c). Pub. L. 104-208, Sec. 2411(d), substituted "this section" for "subsections (a) and (b) of this section".

Subsec. (d). Pub. L. 104-208, Sec. 2411(b), added subsec. (d).

Subsec. (e). Pub. L. 104-208, Sec. 2411(c), which added subsec. (e) containing subsec. designation, but no heading or text, was repealed by Pub. L. 108-159, Sec. 811(h).

EFFECTIVE DATE OF 2003 AMENDMENT

Amendment by Pub. L. 108-159 subject to joint regulations establishing effective dates as prescribed by Federal Reserve Board and Federal Trade Commission, except as otherwise provided, see section 3 of Pub. L. 108-159, set out as a note under section 1681 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-208 effective 365 days after Sept. 30, 1996, with special rule for early compliance, see section 2420 of Pub. L. 104-208, set out as a note under section 1681a of this title.

REGULATIONS

Pub. L. 108-159, title II, Sec. 213(b), Dec. 4, 2003, 117 Stat. 1979, provided that: "Regulations required by section 615(d)(2) of the Fair Credit Reporting Act [15 U.S.C. 1681m(d)(2)], as amended by this section, shall be issued in final form not later than 1 year after the date of enactment of this Act [Dec. 4, 2003]."

-FOOTNOTE-

(!1) So in original. Probably should be "creditworthiness,".

(!2) So in original. Probably should be "creditworthiness".

Copyright © 2009 Association of Corporate Counsel

Electronic Code of Federal Regulations
e-CFR™

e-CFR Data is current as of August 14, 2009

Title 12: Banks and Banking

PART 222—FAIR CREDIT REPORTING (REGULATION V)

Browse Previous

Subpart J—Identity Theft Red Flags

Source: Reg. V, 72 FR 63758, Nov. 9, 2007, unless otherwise noted.

§ 222.90 Duties regarding the detection, prevention, and mitigation of identity theft.

(a) *Scope*. This section applies to financial institutions and creditors that are member banks of the Federal Reserve System (other than national banks) and their respective operating subsidiaries that are not functionally regulated within the meaning of section 5(c)(5) of the Bank Holding Company Act, as amended (12 U.S.C. 1844(c)(5)), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.* , and 611 *et seq.*).

(b) *Definitions*. For purposes of this section and appendix J, the following definitions apply:

(1) *Account* means a continuing relationship established by a person with a financial institution or creditor to obtain a product or service for personal, family, household or business purposes. Account includes:

(i) An extension of credit, such as the purchase of property or services involving a deferred payment; and

(ii) A deposit account.

(2) The term *board of directors* includes:

(i) In the case of a branch or agency of a foreign bank, the managing official in charge of the branch or agency; and

(ii) In the case of any other creditor that does not have a board of directors, a designated employee at the level of senior management.

(3) *Covered account* means:

(i) An account that a financial institution or creditor offers or maintains, primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions, such as a credit card account, mortgage loan, automobile loan, margin account, cell phone account, utility account, checking account, or savings account; and

Copyright © 2009 Association of Corporate Counsel

(ii) Any other account that the financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks.

(4) *Credit* has the same meaning as in 15 U.S.C. 1681a(r)(5).

(5) *Creditor* has the same meaning as in 15 U.S.C. 1681a(r)(5), and includes lenders such as banks, finance companies, automobile dealers, mortgage brokers, utility companies, and telecommunications companies.

(6) *Customer* means a person that has a covered account with a financial institution or creditor.

(7) *Financial institution* has the same meaning as in 15 U.S.C. 1681a(t).

(8) *Identity theft* has the same meaning as in 16 CFR 603.2(a).

(9) *Red Flag* means a pattern, practice, or specific activity that indicates the possible existence of identity theft.

(10) *Service provider* means a person that provides a service directly to the financial institution or creditor.

(c) *Periodic Identification of Covered Accounts.* Each financial institution or creditor must periodically determine whether it offers or maintains covered accounts. As a part of this determination, a financial institution or creditor must conduct a risk assessment to determine whether it offers or maintains covered accounts described in paragraph (b)(3)(ii) of this section, taking into consideration:

(1) The methods it provides to open its accounts;

(2) The methods it provides to access its accounts; and

(3) Its previous experiences with identity theft.

(d) *Establishment of an Identity Theft Prevention Program* —(1) *Program requirement.* Each financial institution or creditor that offers or maintains one or more covered accounts must develop and implement a written Identity Theft Prevention Program (Program) that is designed to detect, prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account. The Program must be appropriate to the size and complexity of the financial institution or creditor and the nature and scope of its activities.

(2) *Elements of the Program.* The Program must include reasonable policies and procedures to:

(i) Identify relevant Red Flags for the covered accounts that the financial institution or creditor offers or maintains, and incorporate those Red Flags into its Program;

(ii) Detect Red Flags that have been incorporated into the Program of the financial institution or creditor;

(iii) Respond appropriately to any Red Flags that are detected pursuant to paragraph (d)(2)(ii) of this section to prevent and mitigate identity theft; and

(iv) Ensure the Program (including the Red Flags determined to be relevant) is updated periodically, to reflect changes in risks to customers and to the safety and soundness of the financial institution or creditor from identity theft.

(e) *Administration of the Program.* Each financial institution or creditor that is required to implement a Program must provide for the continued administration of the Program and must:

(1) Obtain approval of the initial written Program from either its board of directors or an appropriate

Copyright © 2009 Association of Corporate Counsel

committee of the board of directors;

(2) Involve the board of directors, an appropriate committee thereof, or a designated employee at the level of senior management in the oversight, development, implementation and administration of the Program;

(3) Train staff, as necessary, to effectively implement the Program; and

(4) Exercise appropriate and effective oversight of service provider arrangements.

(f) *Guidelines.* Each financial institution or creditor that is required to implement a Program must consider the guidelines in appendix J of this part and include in its Program those guidelines that are appropriate.

[Reg. V, 72 FR 63758, Nov. 9, 2007, as amended at 74 FR 22642, May 14, 2009]

§ 222.91 Duties of card issuers regarding changes of address.

(a) *Scope.* This section applies to a person described in §222.90(a) that issues a debit or credit card (card issuer).

(b) *Definitions.* For purposes of this section:

(1) *Cardholder* means a consumer who has been issued a credit or debit card.

(2) *Clear and conspicuous* means reasonably understandable and designed to call attention to the nature and significance of the information presented.

(c) *Address validation requirements.* A card issuer must establish and implement reasonable policies and procedures to assess the validity of a change of address if it receives notification of a change of address for a consumer's debit or credit card account and, within a short period of time afterwards (during at least the first 30 days after it receives such notification), the card issuer receives a request for an additional or replacement card for the same account. Under these circumstances, the card issuer may not issue an additional or replacement card, until, in accordance with its reasonable policies and procedures and for the purpose of assessing the validity of the change of address, the card issuer:

(1)(i) Notifies the cardholder of the request:

(A) At the cardholder's former address; or

(B) By any other means of communication that the card issuer and the cardholder have previously agreed to use; and

(ii) Provides to the cardholder a reasonable means of promptly reporting incorrect address changes; or

(2) Otherwise assesses the validity of the change of address in accordance with the policies and procedures the card issuer has established pursuant to §222.90 of this part.

(d) *Alternative timing of address validation.* A card issuer may satisfy the requirements of paragraph (c) of this section if it validates an address pursuant to the methods in paragraph (c)(1) or (c)(2) of this section when it receives an address change notification, before it receives a request for an additional or replacement card.

(e) *Form of notice.* Any written or electronic notice that the card issuer provides under this paragraph must be clear and conspicuous and provided separately from its regular correspondence with the cardholder.

Appendix A to Part 222 [Reserved]

Copyright © 2009 Association of Corporate Counsel

Appendix B to Part 222—Model Notices of Furnishing Negative Information

a. Although use of the model notices is not required, a financial institution that is subject to section 623 (a)(7) of the FCRA shall be deemed to be in compliance with the notice requirement in section 623(a)(7) of the FCRA if the institution properly uses the model notices in this appendix (as applicable).

b. A financial institution may use Model Notice B–1 if the institution provides the notice prior to furnishing negative information to a nationwide consumer reporting agency.

c. A financial institution may use Model Notice B–2 if the institution provides the notice after furnishing negative information to a nationwide consumer reporting agency.

d. Financial institutions may make certain changes to the language or format of the model notices without losing the safe harbor from liability provided by the model notices. The changes to the model notices may not be so extensive as to affect the substance, clarity, or meaningful sequence of the language in the model notices. Financial institutions making such extensive revisions will lose the safe harbor from liability that this appendix provides. Acceptable changes include, for example,

1. Rearranging the order of the references to “late payment(s),” or “missed payment(s)”

2. Pluralizing the terms “credit bureau,” “credit report,” and “account”

3. Specifying the particular type of account on which information may be furnished, such as “credit card account”

4. Rearranging in Model Notice B–1 the phrases “information about your account” and “to credit bureaus” such that it would read “We may report to credit bureaus information about your account.”

Model Notice B–1

We may report information about your account to credit bureaus. Late payments, missed payments, or other defaults on your account may be reflected in your credit report.

Model Notice B–2

We have told a credit bureau about a late payment, missed payment or other default on your account. This information may be reflected in your credit report.

[69 FR 33285, June 15, 2004]

Appendix C to Part 222—Model Forms for Opt-Out Notices

Link to an amendment published at 74 FR 22642, May 14, 2009.

a. Although use of the model forms is not required, use of the model forms in this appendix (as applicable) complies with the requirement in section 624 of the Act for clear, conspicuous, and concise notices.

b. Certain changes may be made to the language or format of the model forms without losing the protection from liability afforded by use of the model forms. These changes may not be so extensive as to affect the substance, clarity, or meaningful sequence of the language in the model forms. Persons making such extensive revisions will lose the safe harbor that this appendix provides. Acceptable changes include, for example:

1. Rearranging the order of the references to “your income,” “your account history,” and “your credit score.”

2. Substituting other types of information for “income,” “account history,” or “credit score” for accuracy,

Copyright © 2009 Association of Corporate Counsel

such as “payment history,” “credit history,” “payoff status,” or “claims history.”

3. Substituting a clearer and more accurate description of the affiliates providing or covered by the notice for phrases such as “the [ABC] group of companies,” including without limitation a statement that the entity providing the notice recently purchased the consumer's account.

4. Substituting other types of affiliates covered by the notice for “credit card,” “insurance,” or “securities” affiliates.

5. Omitting items that are not accurate or applicable. For example, if a person does not limit the duration of the opt-out period, the notice may omit information about the renewal notice.

6. Adding a statement informing consumers how much time they have to opt out before shared eligibility information may be used to make solicitations to them.

7. Adding a statement that the consumer may exercise the right to opt out at any time.

8. Adding the following statement, if accurate: “If you previously opted out, you do not need to do so again.”

9. Providing a place on the form for the consumer to fill in identifying information, such as his or her name and address.

10. Adding disclosures regarding the treatment of opt-outs by joint consumers to comply with §222.23(a)(2) of this part.

C–1 Model Form for Initial Opt-out Notice (Single-Affiliate Notice)

C–2 Model Form for Initial Opt-out Notice (Joint Notice)

C–3 Model Form for Renewal Notice (Single-Affiliate Notice)

C–4 Model Form for Renewal Notice (Joint Notice)

C–5 Model Form for Voluntary “No Marketing” Notice

C–6 Model Form for Voluntary “No Marketing” Notice

C–1—Model Form for Initial Opt-out Notice (Single-Affiliate Notice)—[Your Choice To Limit Marketing]/[Marketing Opt-out]

• [Name of Affiliate] is providing this notice.

• [Optional: Federal law gives you the right to limit some but not all marketing from our affiliates. Federal law also requires us to give you this notice to tell you about your choice to limit marketing from our affiliates.]

• You may limit our affiliates in the [ABC] group of companies, such as our [credit card, insurance, and securities] affiliates, from marketing their products or services to you based on your personal information that we collect and share with them. This information includes your [income], your [account history with us], and your [credit score].

• Your choice to limit marketing offers from our affiliates will apply [until you tell us to change your choice]/[for x years from when you tell us your choice]/[for at least 5 years from when you tell us your choice]. [Include if the opt-out period expires.] Once that period expires, you will receive a renewal notice that will allow you to continue to limit marketing offers from our affiliates for [another x years]/[at least another 5 years].

Copyright © 2009 Association of Corporate Counsel

• [Include, if applicable, in a subsequent notice, including an annual notice, for consumers who may have previously opted out.] If you have already made a choice to limit marketing offers from our affiliates, you do not need to act again until you receive the renewal notice.

To limit marketing offers, contact us [include all that apply]:

• By telephone: 1–877–###–####

• On the Web: *www.—.com*

• By mail: Check the box and complete the form below, and send the form to:

[Company name]

[Company address]

_Do not allow your affiliates to use my personal information to market to me.

C–2—Model Form for Initial Opt-out Notice (Joint Notice)—[Your Choice To Limit Marketing]/[Marketing Opt-out]

• The [ABC group of companies] is providing this notice.

• [Optional: Federal law gives you the right to limit some but not all marketing from the [ABC] companies. Federal law also requires us to give you this notice to tell you about your choice to limit marketing from the [ABC] companies.]

• You may limit the [ABC] companies, such as the [ABC credit card, insurance, and securities] affiliates, from marketing their products or services to you based on your personal information that they receive from other [ABC] companies. This information includes your [income], your [account history], and your [credit score].

• Your choice to limit marketing offers from the [ABC] companies will apply [until you tell us to change your choice]/[for x years from when you tell us your choice]/[for at least 5 years from when you tell us your choice]. [Include if the opt-out period expires.] Once that period expires, you will receive a renewal notice that will allow you to continue to limit marketing offers from the [ABC] companies for [another x years]/[at least another 5 years].

• [Include, if applicable, in a subsequent notice, including an annual notice, for consumers who may have previously opted out.] If you have already made a choice to limit marketing offers from the [ABC] companies, you do not need to act again until you receive the renewal notice.

To limit marketing offers, contact us [include all that apply]:

• By telephone: 1–877–###–####

• On the Web: *www.—.com*

• By mail: Check the box and complete the form below, and send the form to:

[Company name]

[Company address]

_Do not allow any company [in the ABC group of companies] to use my personal information to market to me.

C–3—Model Form for Renewal Notice (Single-Affiliate Notice)—[Renewing Your Choice To Limit

Copyright © 2009 Association of Corporate Counsel

Marketing]/[Renewing Your Marketing Opt-Out]

• [Name of Affiliate] is providing this notice.

• [Optional: Federal law gives you the right to limit some but not all marketing from our affiliates. Federal law also requires us to give you this notice to tell you about your choice to limit marketing from our affiliates.]

• You previously chose to limit our affiliates in the [ABC] group of companies, such as our [credit card, insurance, and securities] affiliates, from marketing their products or services to you based on your personal information that we share with them. This information includes your [income], your [account history with us], and your [credit score].

• Your choice has expired or is about to expire.

To renew your choice to limit marketing for [x] more years, contact us [include all that apply]:

• By telephone: 1–877–###–####

• On the Web: *www.---.com*

• By mail: Check the box and complete the form below, and send the form to:

[Company name]

[Company address]

_Renew my choice to limit marketing for [x] more years.

C–4—Model Form for Renewal Notice (Joint Notice)—[Renewing Your Choice To Limit Marketing]/ [Renewing Your Marketing Opt-Out]

• The [ABC group of companies] is providing this notice.

• [Optional: Federal law gives you the right to limit some but not all marketing from the [ABC] companies. Federal law also requires us to give you this notice to tell you about your choice to limit marketing from the [ABC] companies.]

• You previously chose to limit the [ABC] companies, such as the [ABC credit card, insurance, and securities] affiliates, from marketing their products or services to you based on your personal information that they receive from other ABC companies. This information includes your [income], your [account history], and your [credit score].

• Your choice has expired or is about to expire.

To renew your choice to limit marketing for [x] more years, contact us [include all that apply]:

• By telephone: 1–877–###–####

• On the Web: *www.---.com*

• By mail: Check the box and complete the form below, and send the form to:

[Company name]

[Company address]

Copyright © 2009 Association of Corporate Counsel

_Renew my choice to limit marketing for [x] more years.

C–5—Model Form for Voluntary "No Marketing" Notice

Your Choice To Stop Marketing

• [Name of Affiliate] is providing this notice.

• You may choose to stop all marketing from us and our affiliates.

• [Your choice to stop marketing from us and our affiliates will apply until you tell us to change your choice.]

To stop all marketing, contact us [include all that apply]:

• By telephone: 1–877–###–####

• On the Web: www.—.com

• By mail: Check the box and complete the form below, and send the form to:

[Company name]

[Company address]

_Do not market to me.

C–6—Model Form for Voluntary "No Marketing" Notice—Your Choice To Stop Marketing

• [Name of Affiliate] is providing this notice.

• You may choose to stop all marketing from us and our affiliates.

To stop all marketing, contact us [include all that apply]:

• By telephone: 1–877–###–####

• On the Web: www.---.com

• By mail: Check the box and complete the form below, and send the form to:

[Company name]

[Company address]

_Do not market to me.

[72 FR 62962, Nov. 7, 2007, as amended at 74 FR 22642, May 14, 2009]

Appendix D to Part 222 [Reserved]

Appendix E to Part 222—XXX

Link to an amendment published at 74 FR 31516, July 1, 2009.

Copyright © 2009 Association of Corporate Counsel

Appendices F–I to Part 222 [Reserved]

Appendix J to Part 222—Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation

Section 222.90 of this part requires each financial institution and creditor that offers or maintains one or more covered accounts, as defined in §222.90(b)(3) of this part, to develop and provide for the continued administration of a written Program to detect, prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account. These guidelines are intended to assist financial institutions and creditors in the formulation and maintenance of a Program that satisfies the requirements of §222.90 of this part.

I. The Program

In designing its Program, a financial institution or creditor may incorporate, as appropriate, its existing policies, procedures, and other arrangements that control reasonably foreseeable risks to customers or to the safety and soundness of the financial institution or creditor from identity theft.

II. Identifying Relevant Red Flags

(a) *Risk Factors.* A financial institution or creditor should consider the following factors in identifying relevant Red Flags for covered accounts, as appropriate:

(1) The types of covered accounts it offers or maintains;

(2) The methods it provides to open its covered accounts;

(3) The methods it provides to access its covered accounts; and

(4) Its previous experiences with identity theft.

(b) *Sources of Red Flags.* Financial institutions and creditors should incorporate relevant Red Flags from sources such as:

(1) Incidents of identity theft that the financial institution or creditor has experienced;

(2) Methods of identity theft that the financial institution or creditor has identified that reflect changes in identity theft risks; and

(3) Applicable supervisory guidance.

(c) *Categories of Red Flags.* The Program should include relevant Red Flags from the following categories, as appropriate. Examples of Red Flags from each of these categories are appended as Supplement A to this appendix J.

(1) Alerts, notifications, or other warnings received from consumer reporting agencies or service providers, such as fraud detection services;

(2) The presentation of suspicious documents;

(3) The presentation of suspicious personal identifying information, such as a suspicious address change;

(4) The unusual use of, or other suspicious activity related to, a covered account; and

Copyright © 2009 Association of Corporate Counsel

(5) Notice from customers, victims of identity theft, law enforcement authorities, or other persons regarding possible identity theft in connection with covered accounts held by the financial institution or creditor.

III. Detecting Red Flags

The Program's policies and procedures should address the detection of Red Flags in connection with the opening of covered accounts and existing covered accounts, such as by:

(a) Obtaining identifying information about, and verifying the identity of, a person opening a covered account, for example, using the policies and procedures regarding identification and verification set forth in the Customer Identification Program rules implementing 31 U.S.C. 5318(l) (31 CFR 103.121); and

(b) Authenticating customers, monitoring transactions, and verifying the validity of change of address requests, in the case of existing covered accounts.

IV. Preventing and Mitigating Identity Theft

The Program's policies and procedures should provide for appropriate responses to the Red Flags the financial institution or creditor has detected that are commensurate with the degree of risk posed. In determining an appropriate response, a financial institution or creditor should consider aggravating factors that may heighten the risk of identity theft, such as a data security incident that results in unauthorized access to a customer's account records held by the financial institution, creditor, or third party, or notice that a customer has provided information related to a covered account held by the financial institution or creditor to someone fraudulently claiming to represent the financial institution or creditor or to a fraudulent website. Appropriate responses may include the following:

(a) Monitoring a covered account for evidence of identity theft;

(b) Contacting the customer;

(c) Changing any passwords, security codes, or other security devices that permit access to a covered account;

(d) Reopening a covered account with a new account number;

(e) Not opening a new covered account;

(f) Closing an existing covered account;

(g) Not attempting to collect on a covered account or not selling a covered account to a debt collector;

(h) Notifying law enforcement; or

(i) Determining that no response is warranted under the particular circumstances.

V. Updating the Program

Financial institutions and creditors should update the Program (including the Red Flags determined to be relevant) periodically, to reflect changes in risks to customers or to the safety and soundness of the financial institution or creditor from identity theft, based on factors such as:

(a) The experiences of the financial institution or creditor with identity theft;

(b) Changes in methods of identity theft;

(c) Changes in methods to detect, prevent, and mitigate identity theft;

Copyright © 2009 Association of Corporate Counsel

(d) Changes in the types of accounts that the financial institution or creditor offers or maintains; and

(e) Changes in the business arrangements of the financial institution or creditor, including mergers, acquisitions, alliances, joint ventures, and service provider arrangements.

VI. Methods for Administering the Program

(a) *Oversight of Program.* Oversight by the board of directors, an appropriate committee of the board, or a designated employee at the level of senior management should include:

(1) Assigning specific responsibility for the Program's implementation;

(2) Reviewing reports prepared by staff regarding compliance by the financial institution or creditor with §222.90 of this part; and

(3) Approving material changes to the Program as necessary to address changing identity theft risks.

(b) *Reports.* (1) *In general.* Staff of the financial institution or creditor responsible for development, implementation, and administration of its Program should report to the board of directors, an appropriate committee of the board, or a designated employee at the level of senior management, at least annually, on compliance by the financial institution or creditor with §222.90 of this part.

(2) *Contents of report.* The report should address material matters related to the Program and evaluate issues such as: the effectiveness of the policies and procedures of the financial institution or creditor in addressing the risk of identity theft in connection with the opening of covered accounts and with respect to existing covered accounts; service provider arrangements; significant incidents involving identity theft and management's response; and recommendations for material changes to the Program.

(c) *Oversight of service provider arrangements.* Whenever a financial institution or creditor engages a service provider to perform an activity in connection with one or more covered accounts the financial institution or creditor should take steps to ensure that the activity of the service provider is conducted in accordance with reasonable policies and procedures designed to detect, prevent, and mitigate the risk of identity theft. For example, a financial institution or creditor could require the service provider by contract to have policies and procedures to detect relevant Red Flags that may arise in the performance of the service provider's activities, and either report the Red Flags to the financial institution or creditor, or to take appropriate steps to prevent or mitigate identity theft.

VII. Other Applicable Legal Requirements

Financial institutions and creditors should be mindful of other related legal requirements that may be applicable, such as:

(a) For financial institutions and creditors that are subject to 31 U.S.C. 5318(g), filing a Suspicious Activity Report in accordance with applicable law and regulation;

(b) Implementing any requirements under 15 U.S.C. 1681c–1(h) regarding the circumstances under which credit may be extended when the financial institution or creditor detects a fraud or active duty alert;

(c) Implementing any requirements for furnishers of information to consumer reporting agencies under 15 U.S.C. 1681s–2, for example, to correct or update inaccurate or incomplete information, and to not report information that the furnisher has reasonable cause to believe is inaccurate; and

(d) Complying with the prohibitions in 15 U.S.C. 1681m on the sale, transfer, and placement for collection of certain debts resulting from identity theft.

Supplement A to Appendix J

In addition to incorporating Red Flags from the sources recommended in section II.b. of the Guidelines

Copyright © 2009 Association of Corporate Counsel

in appendix J of this part, each financial institution or creditor may consider incorporating into its Program, whether singly or in combination, Red Flags from the following illustrative examples in connection with covered accounts:

Alerts, Notifications or Warnings from a Consumer Reporting Agency

1. A fraud or active duty alert is included with a consumer report.

2. A consumer reporting agency provides a notice of credit freeze in response to a request for a consumer report.

3. A consumer reporting agency provides a notice of address discrepancy, as defined in §222.82(b) of this part.

4. A consumer report indicates a pattern of activity that is inconsistent with the history and usual pattern of activity of an applicant or customer, such as:

a. A recent and significant increase in the volume of inquiries;

b. An unusual number of recently established credit relationships;

c. A material change in the use of credit, especially with respect to recently established credit relationships; or

d. An account that was closed for cause or identified for abuse of account privileges by a financial institution or creditor.

Suspicious Documents

5. Documents provided for identification appear to have been altered or forged.

6. The photograph or physical description on the identification is not consistent with the appearance of the applicant or customer presenting the identification.

7. Other information on the identification is not consistent with information provided by the person opening a new covered account or customer presenting the identification.

8. Other information on the identification is not consistent with readily accessible information that is on file with the financial institution or creditor, such as a signature card or a recent check.

9. An application appears to have been altered or forged, or gives the appearance of having been destroyed and reassembled.

Suspicious Personal Identifying Information

10. Personal identifying information provided is inconsistent when compared against external information sources used by the financial institution or creditor. For example:

a. The address does not match any address in the consumer report; or

b. The Social Security Number (SSN) has not been issued, or is listed on the Social Security Administration's Death Master File.

11. Personal identifying information provided by the customer is not consistent with other personal identifying information provided by the customer. For example, there is a lack of correlation between the SSN range and date of birth.

12. Personal identifying information provided is associated with known fraudulent activity as indicated by

Copyright © 2009 Association of Corporate Counsel

internal or third-party sources used by the financial institution or creditor. For example:

a. The address on an application is the same as the address provided on a fraudulent application; or

b. The phone number on an application is the same as the number provided on a fraudulent application.

13. Personal identifying information provided is of a type commonly associated with fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor. For example:

a. The address on an application is fictitious, a mail drop, or a prison; or

b. The phone number is invalid, or is associated with a pager or answering service.

14. The SSN provided is the same as that submitted by other persons opening an account or other customers.

15. The address or telephone number provided is the same as or similar to the address or telephone number submitted by an unusually large number of other persons opening accounts or by other customers.

16. The person opening the covered account or the customer fails to provide all required personal identifying information on an application or in response to notification that the application is incomplete.

17. Personal identifying information provided is not consistent with personal identifying information that is on file with the financial institution or creditor.

18. For financial institutions and creditors that use challenge questions, the person opening the covered account or the customer cannot provide authenticating information beyond that which generally would be available from a wallet or consumer report.

Unusual Use of, or Suspicious Activity Related to, the Covered Account

19. Shortly following the notice of a change of address for a covered account, the institution or creditor receives a request for a new, additional, or replacement card or a cell phone, or for the addition of authorized users on the account.

20. A new revolving credit account is used in a manner commonly associated with known patterns of fraud. For example:

a. The majority of available credit is used for cash advances or merchandise that is easily convertible to cash (e.g., electronics equipment or jewelry); or

b. The customer fails to make the first payment or makes an initial payment but no subsequent payments.

21. A covered account is used in a manner that is not consistent with established patterns of activity on the account. There is, for example:

a. Nonpayment when there is no history of late or missed payments;

b. A material increase in the use of available credit;

c. A material change in purchasing or spending patterns;

d. A material change in electronic fund transfer patterns in connection with a deposit account; or

e. A material change in telephone call patterns in connection with a cellular phone account.

Copyright © 2009 Association of Corporate Counsel

22. A covered account that has been inactive for a reasonably lengthy period of time is used (taking into consideration the type of account, the expected pattern of usage and other relevant factors).

23. Mail sent to the customer is returned repeatedly as undeliverable although transactions continue to be conducted in connection with the customer's covered account.

24. The financial institution or creditor is notified that the customer is not receiving paper account statements.

25. The financial institution or creditor is notified of unauthorized charges or transactions in connection with a customer's covered account.

Notice from Customers, Victims of Identity Theft, Law Enforcement Authorities, or Other Persons Regarding Possible Identity Theft in Connection with Covered Accounts Held by the Financial Institution or Creditor

26. The financial institution or creditor is notified by a customer, a victim of identity theft, a law enforcement authority, or any other person that it has opened a fraudulent account for a person engaged in identity theft.

[Reg. V, 72 FR 63758, Nov. 9, 2007, as amended at 74 FR 22642, May 14, 2009]

Browse Previous

For questions or comments regarding e-CFR editorial content, features, or design, email ecfr@nara.gov.

For questions concerning e-CFR programming and delivery issues, email webteam@gpo.gov.

Section 508 / Accessibility

Copyright © 2009 Association of Corporate Counsel

Home Search Download Classification Codification Popular Names About

Office of the Law Revision Counsel, U.S. House of Representatives

Copyright © 2009 Association of Corporate Counsel

Fair Credit Reporting Act Section 624 (15 USC 1681s-3)

Fair Credit Reporting Affiliate Marketing Regulations – Subpart C to Regulation V

Copyright © 2009 Association of Corporate Counsel

Office of the Law Revision Counsel, U.S. House of Representatives
Home Search Download Classification Codification Popular Names About

Go to 1st query term(s)

-CITE-

15 USC Sec. ***1681s-3*** 01/08/2008

-EXPCITE-

TITLE 15 - COMMERCE AND TRADE

CHAPTER 41 - CONSUMER CREDIT PROTECTION

SUBCHAPTER III - CREDIT REPORTING AGENCIES

-HEAD-

Sec. 1681s-3. Affiliate sharing

-STATUTE-

(a) Special rule for solicitation for purposes of marketing

(1) Notice

Any person that receives from another person related to it by common ownership or affiliated by corporate control a communication of information that would be a consumer report, but for clauses (i), (ii), and (iii) of section 1681a(d)(2)(A) of this title, may not use the information to make a solicitation for marketing purposes to a consumer about its products or services, unless -

(A) it is clearly and conspicuously disclosed to the consumer that the information may be communicated among such persons for purposes of making such solicitations to the consumer; and

(B) the consumer is provided an opportunity and a simple method to prohibit the making of such solicitations to the consumer by such person.

(2) Consumer choice

(A) In general

The notice required under paragraph (1) shall allow the consumer the opportunity to prohibit all solicitations referred to in such paragraph, and may allow the consumer to choose from different options when electing to prohibit the sending of such solicitations, including options regarding the types of entities and information covered, and which methods of delivering solicitations the consumer elects to prohibit.

(B) Format

Notwithstanding subparagraph (A), the notice required under paragraph (1) shall be clear, conspicuous, and concise, and any method provided under paragraph (1)(B) shall be simple. The regulations prescribed to implement this section shall provide specific guidance regarding how to comply with such standards.

(3) Duration

(A) In general

The election of a consumer pursuant to paragraph (1)(B) to prohibit the making of solicitations shall be effective for at least 5 years, beginning on the date on which the person receives the election of the consumer, unless the consumer requests that such election be revoked.

(B) Notice upon expiration of effective period

At such time as the election of a consumer pursuant to paragraph (1)(B) is no longer effective, a person may not use information that the person receives in the manner described in paragraph (1) to make any solicitation for marketing purposes to the consumer, unless the consumer receives a notice and an opportunity, using a simple method, to extend the opt-out for another period of at least 5 years, pursuant to the procedures described in paragraph (1).

Copyright © 2009 Association of Corporate Counsel

(4) Scope

This section shall not apply to a person -

(A) using information to make a solicitation for marketing purposes to a consumer with whom the person has a pre-existing business relationship;

(B) using information to facilitate communications to an individual for whose benefit the person provides employee benefit or other services pursuant to a contract with an employer related to and arising out of the current employment relationship or status of the individual as a participant or beneficiary of an employee benefit plan;

(C) using information to perform services on behalf of another person related by common ownership or affiliated by corporate control, except that this subparagraph shall not be construed as permitting a person to send solicitations on behalf of another person, if such other person would not be permitted to send the solicitation on its own behalf as a result of the election of the consumer to prohibit solicitations under paragraph (1)(B);

(D) using information in response to a communication initiated by the consumer;

(E) using information in response to solicitations authorized or requested by the consumer; or

(F) if compliance with this section by that person would prevent compliance by that person with any provision of State insurance laws pertaining to unfair discrimination in any State in which the person is lawfully doing business.

(5) No retroactivity

This subsection shall not prohibit the use of information to send a solicitation to a consumer if such information was

Copyright © 2009 Association of Corporate Counsel

received prior to the date on which persons are required to comply with regulations implementing this subsection.

(b) Notice for other purposes permissible

A notice or other disclosure under this section may be coordinated and consolidated with any other notice required to be issued under any other provision of law by a person that is subject to this section, and a notice or other disclosure that is equivalent to the notice required by subsection (a) of this section, and that is provided by a person described in subsection (a) of this section to a consumer together with disclosures required by any other provision of law, shall satisfy the requirements of subsection (a) of this section.

(c) User requirements

Requirements with respect to the use by a person of information received from another person related to it by common ownership or affiliated by corporate control, such as the requirements of this section, constitute requirements with respect to the exchange of information among persons affiliated by common ownership or common corporate control, within the meaning of section 1681t(b)(2) of this title.

(d) Definitions

For purposes of this section, the following definitions shall apply:

(1) Pre-existing business relationship

The term "pre-existing business relationship" means a relationship between a person, or a person's licensed agent, and a consumer, based on -

(A) a financial contract between a person and a consumer which is in force;

(B) the purchase, rental, or lease by the consumer of that

Copyright © 2009 Association of Corporate Counsel

person's goods or services, or a financial transaction (including holding an active account or a policy in force or having another continuing relationship) between the consumer and that person during the 18-month period immediately preceding the date on which the consumer is sent a solicitation covered by this section;

(C) an inquiry or application by the consumer regarding a product or service offered by that person, during the 3-month period immediately preceding the date on which the consumer is sent a solicitation covered by this section; or

(D) any other pre-existing customer relationship defined in the regulations implementing this section.

(2) Solicitation

The term "solicitation" means the marketing of a product or service initiated by a person to a particular consumer that is based on an exchange of information described in subsection (a) of this section, and is intended to encourage the consumer to purchase such product or service, but does not include communications that are directed at the general public or determined not to be a solicitation by the regulations prescribed under this section.

-SOURCE-

(Pub. L. 90-321, title VI, Sec. 624, as added Pub. L. 108-159, title II, Sec. 214(a)(2), Dec. 4, 2003, 117 Stat. 1980.)

-MISC1-

PRIOR PROVISIONS

A prior section 624 of Pub. L. 90-321 was renumbered section 625 and is classified to section 1681t of this title.

Another prior section 624 of Pub. L. 90-321 was renumbered section 626 and is classified to section 1681u of this title.

Copyright © 2009 Association of Corporate Counsel

EFFECTIVE DATE

Section subject to joint regulations establishing effective dates as prescribed by Federal Reserve Board and Federal Trade Commission, except as otherwise provided, see section 3 of Pub. L. 108-159, set out as an Effective Date of 2003 Amendment note under section 1681 of this title.

REGULATIONS

Pub. L. 108-159, title II, Sec. 214(b), Dec. 4, 2003, 117 Stat. 1982, provided that:

"(1) In general. - The Federal banking agencies, the National Credit Union Administration, and the Commission, with respect to the entities that are subject to their respective enforcement authority under section 621 of the Fair Credit Reporting Act [15 U.S.C. 1681s] and the Securities and Exchange Commission, and in coordination as described in paragraph (2), shall prescribe regulations to implement section 624 of the Fair Credit Reporting Act [15 U.S.C. 1681s-3], as added by this section.

"(2) Coordination. - Each agency required to prescribe regulations under paragraph (1) shall consult and coordinate with each other such agency so that, to the extent possible, the regulations prescribed by each such entity are consistent and comparable with the regulations prescribed by each other such agency.

"(3) Considerations. - In promulgating regulations under this subsection, each agency referred to in paragraph (1) shall -

"(A) ensure that affiliate sharing notification methods provide a simple means for consumers to make determinations and choices under section 624 of the Fair Credit Reporting Act [15 U.S.C. 1681s-3], as added by this section;

"(B) consider the affiliate sharing notification practices

Copyright © 2009 Association of Corporate Counsel

employed on the date of enactment of this Act [Dec. 4, 2003] by persons that will be subject to that section 624; and

"(C) ensure that notices and disclosures may be coordinated and consolidated, as provided in subsection (b) of that section 624.

"(4) Timing. - Regulations required by this subsection shall -

"(A) be issued in final form not later than 9 months after the date of enactment of this Act [Dec. 4, 2003]; and

"(B) become effective not later than 6 months after the date on which they are issued in final form."

[For definitions of terms used in section 214(b) of Pub. L. 108-159, set out above, see section 2 of Pub. L. 108-159, set out as a Definitions note under section 1681 of this title.]

STUDIES OF INFORMATION SHARING PRACTICES

Pub. L. 108-159, title II, Sec. 214(e), Dec. 4, 2003, 117 Stat. 1983, provided that:

"(1) In general. - The Federal banking agencies, the National Credit Union Administration, and the Commission shall jointly conduct regular studies of the consumer information sharing practices by financial institutions and other persons that are creditors or users of consumer reports with their affiliates.

"(2) Matters for study. - In conducting the studies required by paragraph (1), the agencies described in paragraph (1) shall -

"(A) identify -

"(i) the purposes for which financial institutions and other creditors and users of consumer reports share consumer information;

"(ii) the types of information shared by such entities with their affiliates;

"(iii) the number of choices provided to consumers with respect to the control of such sharing, and the degree to and

Copyright © 2009 Association of Corporate Counsel

manner in which consumers exercise such choices, if at all; and

"(iv) whether such entities share or may share personally identifiable transaction or experience information with affiliates for purposes -

"(I) that are related to employment or hiring, including whether the person that is the subject of such information is given notice of such sharing, and the specific uses of such shared information; or

"(II) of general publication of such information; and

"(B) specifically examine the information sharing practices that financial institutions and other creditors and users of consumer reports and their affiliates employ for the purpose of making underwriting decisions or credit evaluations of consumers.

"(3) Reports. -

"(A) Initial report. - Not later than 3 years after the date of enactment of this Act [Dec. 4, 2003], the Federal banking agencies, the National Credit Union Administration, and the Commission shall jointly submit a report to the Congress on the results of the initial study conducted in accordance with this subsection, together with any recommendations for legislative or regulatory action.

"(B) Followup reports. - The Federal banking agencies, the National Credit Union Administration, and the Commission shall, not less frequently than once every 3 years following the date of submission of the initial report under subparagraph (A), jointly submit a report to the Congress that, together with any recommendations for legislative or regulatory action -

"(i) documents any changes in the areas of study referred to in paragraph (2)(A) occurring since the date of submission of the previous report;

Copyright © 2009 Association of Corporate Counsel

"(ii) identifies any changes in the practices of financial institutions and other creditors and users of consumer reports in sharing consumer information with their affiliates for the purpose of making underwriting decisions or credit evaluations of consumers occurring since the date of submission of the previous report; and

"(iii) examines the effects that changes described in clause (ii) have had, if any, on the degree to which such affiliate sharing practices reduce the need for financial institutions, creditors, and other users of consumer reports to rely on consumer reports for such decisions."

[For definitions of terms used in section 214(e) of Pub. L. 108-159, set out above, see section 2 of Pub. L. 108-159, set out as a Definitions note under section 1681 of this title.]

Office of the Law Revision Counsel, U.S. House of Representatives

Copyright © 2009 Association of Corporate Counsel

Copyright © 2009 Association of Corporate Counsel

Electronic Code of Federal Regulations
e-CFR TM

e-CFR Data is current as of August 14, 2009

Title 12: Banks and Banking

PART 222—FAIR CREDIT REPORTING (REGULATION V)

Browse Previous | Browse Next

Subpart C—Affiliate Marketing

Source: Reg. V, 72 FR 62955, Nov. 7, 2007, unless otherwise noted.

§ 222.20 Coverage and definitions.

(a) *Coverage* . Subpart C of this part applies to member banks of the Federal Reserve System (other than national banks) and their respective operating subsidiaries that are not functionally regulated within the meaning of section 5(c)(5) of the Bank Holding Company Act, as amended (12 U.S.C. 1844(c)(5)), branches and Agencies of foreign banks (other than Federal branches, Federal Agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.* , and 611 *et seq.*).

(b) *Definitions* . For purposes of this subpart:

(1) *Clear and conspicuous* . The term "clear and conspicuous" means reasonably understandable and designed to call attention to the nature and significance of the information presented.

(2) *Concise* —(i) *In general* . The term "concise" means a reasonably brief expression or statement.

(ii) *Combination with other required disclosures* . A notice required by this subpart may be concise even if it is combined with other disclosures required or authorized by federal or state law.

(3) *Eligibility information* . The term "eligibility information" means any information the communication of which would be a consumer report if the exclusions from the definition of "consumer report" in section 603(d)(2)(A) of the Act did not apply. Eligibility information does not include aggregate or blind data that does not contain personal identifiers such as account numbers, names, or addresses.

(4) *Pre-existing business relationship* —(i) *In general.* The term "pre-existing business relationship" means a relationship between a person, or a person's licensed agent, and a consumer based on—

(A) A financial contract between the person and the consumer which is in force on the date on which the consumer is sent a solicitation covered by this subpart;

(B) The purchase, rental, or lease by the consumer of the person's goods or services, or a financial transaction (including holding an active account or a policy in force or having another continuing relationship) between the consumer and the person, during the 18-month period immediately preceding the date on which the consumer is sent a solicitation covered by this subpart; or

Copyright © 2009 Association of Corporate Counsel

(C) An inquiry or application by the consumer regarding a product or service offered by that person during the three-month period immediately preceding the date on which the consumer is sent a solicitation covered by this subpart.

(ii) *Examples of pre-existing business relationships* . (A) If a consumer has a time deposit account, such as a certificate of deposit, at a depository institution that is currently in force, the depository institution has a pre-existing business relationship with the consumer and can use eligibility information it receives from its affiliates to make solicitations to the consumer about its products or services.

(B) If a consumer obtained a certificate of deposit from a depository institution, but did not renew the certificate at maturity, the depository institution has a pre-existing business relationship with the consumer and can use eligibility information it receives from its affiliates to make solicitations to the consumer about its products or services for 18 months after the date of maturity of the certificate of deposit.

(C) If a consumer obtains a mortgage, the mortgage lender has a pre-existing business relationship with the consumer. If the mortgage lender sells the consumer's entire loan to an investor, the mortgage lender has a pre-existing business relationship with the consumer and can use eligibility information it receives from its affiliates to make solicitations to the consumer about its products or services for 18 months after the date it sells the loan, and the investor has a pre-existing business relationship with the consumer upon purchasing the loan. If, however, the mortgage lender sells a fractional interest in the consumer's loan to an investor but also retains an ownership interest in the loan, the mortgage lender continues to have a pre-existing business relationship with the consumer, but the investor does not have a pre-existing business relationship with the consumer. If the mortgage lender retains ownership of the loan, but sells ownership of the servicing rights to the consumer's loan, the mortgage lender continues to have a pre-existing business relationship with the consumer. The purchaser of the servicing rights also has a pre-existing business relationship with the consumer as of the date it purchases ownership of the servicing rights, but only if it collects payments from or otherwise deals directly with the consumer on a continuing basis.

(D) If a consumer applies to a depository institution for a product or service that it offers, but does not obtain a product or service from or enter into a financial contract or transaction with the institution, the depository institution has a pre-existing business relationship with the consumer and can therefore use eligibility information it receives from an affiliate to make solicitations to the consumer about its products or services for three months after the date of the application.

(E) If a consumer makes a telephone inquiry to a depository institution about its products or services and provides contact information to the institution, but does not obtain a product or service from or enter into a financial contract or transaction with the institution, the depository institution has a pre-existing business relationship with the consumer and can therefore use eligibility information it receives from an affiliate to make solicitations to the consumer about its products or services for three months after the date of the inquiry.

(F) If a consumer makes an inquiry to a depository institution by e-mail about its products or services, but does not obtain a product or service from or enter into a financial contract or transaction with the institution, the depository institution has a pre-existing business relationship with the consumer and can therefore use eligibility information it receives from an affiliate to make solicitations to the consumer about its products or services for three months after the date of the inquiry.

(G) If a consumer has an existing relationship with a depository institution that is part of a group of affiliated companies, makes a telephone call to the centralized call center for the group of affiliated companies to inquire about products or services offered by the insurance affiliate, and provides contact information to the call center, the call constitutes an inquiry to the insurance affiliate that offers those products or services. The insurance affiliate has a pre-existing business relationship with the consumer and can therefore use eligibility information it receives from its affiliated depository institution to make solicitations to the consumer about its products or services for three months after the date of the inquiry.

(iii) *Examples where no pre-existing business relationship is created* . (A) If a consumer makes a telephone call to a centralized call center for a group of affiliated companies to inquire about the consumer's existing account at a depository institution, the call does not constitute an inquiry to any affiliate other than the depository institution that holds the consumer's account and does not establish a pre-existing business relationship between the consumer and any affiliate of the account-holding depository institution.

Copyright © 2009 Association of Corporate Counsel

(B) If a consumer who has a deposit account with a depository institution makes a telephone call to an affiliate of the institution to ask about the affiliate's retail locations and hours, but does not make an inquiry about the affiliate's products or services, the call does not constitute an inquiry and does not establish a pre-existing business relationship between the consumer and the affiliate. Also, the affiliate's capture of the consumer's telephone number does not constitute an inquiry and does not establish a pre-existing business relationship between the consumer and the affiliate.

(C) If a consumer makes a telephone call to a depository institution in response to an advertisement that offers a free promotional item to consumers who call a toll-free number, but the advertisement does not indicate that the depository institution's products or services will be marketed to consumers who call in response, the call does not create a pre-existing business relationship between the consumer and the depository institution because the consumer has not made an inquiry about a product or service offered by the institution, but has merely responded to an offer for a free promotional item.

(5) *Solicitation* —(i) *In general* . The term “solicitation” means the marketing of a product or service initiated by a person to a particular consumer that is—

(A) Based on eligibility information communicated to that person by its affiliate as described in this subpart; and

(B) Intended to encourage the consumer to purchase or obtain such product or service.

(ii) *Exclusion of marketing directed at the general public.* A solicitation does not include marketing communications that are directed at the general public. For example, television, general circulation magazine, and billboard advertisements do not constitute solicitations, even if those communications are intended to encourage consumers to purchase products and services from the person initiating the communications.

(iii) *Examples of solicitations.* A solicitation would include, for example, a telemarketing call, direct mail, e-mail, or other form of marketing communication directed to a particular consumer that is based on eligibility information received from an affiliate.

(6) *You* means a person described in paragraph (a) of this section.

§ 222.21 Affiliate marketing opt-out and exceptions.

(a) *Initial notice and opt-out requirement* —(1) *In general.* You may not use eligibility information about a consumer that you receive from an affiliate to make a solicitation for marketing purposes to the consumer, unless—

(i) It is clearly and conspicuously disclosed to the consumer in writing or, if the consumer agrees, electronically, in a concise notice that you may use eligibility information about that consumer received from an affiliate to make solicitations for marketing purposes to the consumer;

(ii) The consumer is provided a reasonable opportunity and a reasonable and simple method to “opt out,” or prohibit you from using eligibility information to make solicitations for marketing purposes to the consumer; and

(iii) The consumer has not opted out.

(2) *Example.* A consumer has a homeowner's insurance policy with an insurance company. The insurance company furnishes eligibility information about the consumer to its affiliated depository institution. Based on that eligibility information, the depository institution wants to make a solicitation to the consumer about its home equity loan products. The depository institution does not have a pre-existing business relationship with the consumer and none of the other exceptions apply. The depository institution is prohibited from using eligibility information received from its insurance affiliate to make solicitations to the consumer about its home equity loan products unless the consumer is given a notice and opportunity to opt out and the consumer does not opt out.

(3) *Affiliates who may provide the notice.* The notice required by this paragraph must be provided:

Copyright © 2009 Association of Corporate Counsel

(i) By an affiliate that has or has previously had a pre-existing business relationship with the consumer; or

(ii) As part of a joint notice from two or more members of an affiliated group of companies, provided that at least one of the affiliates on the joint notice has or has previously had a pre-existing business relationship with the consumer.

(b) *Making solicitations* —(1) *In general.* For purposes of this subpart, you make a solicitation for marketing purposes if—

(i) You receive eligibility information from an affiliate;

(ii) You use that eligibility information to do one or more of the following:

(A) Identify the consumer or type of consumer to receive a solicitation;

(B) Establish criteria used to select the consumer to receive a solicitation; or

(C) Decide which of your products or services to market to the consumer or tailor your solicitation to that consumer; and

(iii) As a result of your use of the eligibility information, the consumer is provided a solicitation.

(2) *Receiving eligibility information from an affiliate, including through a common database.* You may receive eligibility information from an affiliate in various ways, including when the affiliate places that information into a common database that you may access.

(3) *Receipt or use of eligibility information by your service provider.* Except as provided in paragraph (b)(5) of this section, you receive or use an affiliate's eligibility information if a service provider acting on your behalf (whether an affiliate or a nonaffiliated third party) receives or uses that information in the manner described in paragraphs (b)(1)(i) or (b)(1)(ii) of this section. All relevant facts and circumstances will determine whether a person is acting as your service provider when it receives or uses an affiliate's eligibility information in connection with marketing your products and services.

(4) *Use by an affiliate of its own eligibility information.* Unless you have used eligibility information that you receive from an affiliate in the manner described in paragraph (b)(1)(ii) of this section, you do not make a solicitation subject to this subpart if your affiliate:

(i) Uses its own eligibility information that it obtained in connection with a pre-existing business relationship it has or had with the consumer to market your products or services to the consumer; or

(ii) Directs its service provider to use the affiliate's own eligibility information that it obtained in connection with a pre-existing business relationship it has or had with the consumer to market your products or services to the consumer, and you do not communicate directly with the service provider regarding that use.

(5) *Use of eligibility information by a service provider* —(i) *In general.* You do not make a solicitation subject to Subpart C of this part if a service provider (including an affiliated or third-party service provider that maintains or accesses a common database that you may access) receives eligibility information from your affiliate that your affiliate obtained in connection with a pre-existing business relationship it has or had with the consumer and uses that eligibility information to market your products or services to the consumer, so long as—

(A) Your affiliate controls access to and use of its eligibility information by the service provider (including the right to establish the specific terms and conditions under which the service provider may use such information to market your products or services);

(B) Your affiliate establishes specific terms and conditions under which the service provider may access and use the affiliate's eligibility information to market your products and services (or those of affiliates generally) to the consumer, such as the identity of the affiliated companies whose products or services

Copyright © 2009 Association of Corporate Counsel

may be marketed to the consumer by the service provider, the types of products or services of affiliated companies that may be marketed, and the number of times the consumer may receive marketing materials, and periodically evaluates the service provider's compliance with those terms and conditions;

(C) Your affiliate requires the service provider to implement reasonable policies and procedures designed to ensure that the service provider uses the affiliate's eligibility information in accordance with the terms and conditions established by the affiliate relating to the marketing of your products or services;

(D) Your affiliate is identified on or with the marketing materials provided to the consumer; and

(E) You do not directly use your affiliate's eligibility information in the manner described in paragraph (b)(1)(ii) of this section.

(ii) *Writing requirements.* (A) The requirements of paragraphs (b)(5)(i)(A) and (C) of this section must be set forth in a written agreement between your affiliate and the service provider; and

(B) The specific terms and conditions established by your affiliate as provided in paragraph (b)(5)(i)(B) of this section must be set forth in writing.

(6) *Examples of making solicitations.* (i) A consumer has a deposit account with a depository institution, which is affiliated with an insurance company. The insurance company receives eligibility information about the consumer from the depository institution. The insurance company uses that eligibility information to identify the consumer to receive a solicitation about insurance products, and, as a result, the insurance company provides a solicitation to the consumer about its insurance products. Pursuant to paragraph (b)(1) of this section, the insurance company has made a solicitation to the consumer.

(ii) The same facts as in the example in paragraph (b)(6)(i) of this section, except that after using the eligibility information to identify the consumer to receive a solicitation about insurance products, the insurance company asks the depository institution to send the solicitation to the consumer and the depository institution does so. Pursuant to paragraph (b)(1) of this section, the insurance company has made a solicitation to the consumer because it used eligibility information about the consumer that it received from an affiliate to identify the consumer to receive a solicitation about its products or services, and, as a result, a solicitation was provided to the consumer about the insurance company's products.

(iii) The same facts as in the example in paragraph (b)(6)(i) of this section, except that eligibility information about consumers that have deposit accounts with the depository institution is placed into a common database that all members of the affiliated group of companies may independently access and use. Without using the depository institution's eligibility information, the insurance company develops selection criteria and provides those criteria, marketing materials, and related instructions to the depository institution. The depository institution reviews eligibility information about its own consumers using the selection criteria provided by the insurance company to determine which consumers should receive the insurance company's marketing materials and sends marketing materials about the insurance company's products to those consumers. Even though the insurance company has received eligibility information through the common database as provided in paragraph (b)(2) of this section, it did not use that information to identify consumers or establish selection criteria; instead, the depository institution used its own eligibility information. Therefore, pursuant to paragraph (b)(4)(i) of this section, the insurance company has not made a solicitation to the consumer.

(iv) The same facts as in the example in paragraph (b)(6)(iii) of this section, except that the depository institution provides the insurance company's criteria to the depository institution's service provider and directs the service provider to use the depository institution's eligibility information to identify depository institution consumers who meet the criteria and to send the insurance company's marketing materials to those consumers. The insurance company does not communicate directly with the service provider regarding the use of the depository institution's information to market its products to the depository institution's consumers. Pursuant to paragraph (b)(4)(ii) of this section, the insurance company has not made a solicitation to the consumer.

(v) An affiliated group of companies includes a depository institution, an insurance company, and a service provider. Each affiliate in the group places information about its consumers into a common database. The service provider has access to all information in the common database. The depository institution controls access to and use of its eligibility information by the service provider. This control is

Copyright © 2009 Association of Corporate Counsel

set forth in a written agreement between the depository institution and the service provider. The written agreement also requires the service provider to establish reasonable policies and procedures designed to ensure that the service provider uses the depository institution's eligibility information in accordance with specific terms and conditions established by the depository institution relating to the marketing of the products and services of all affiliates, including the insurance company. In a separate written communication, the depository institution specifies the terms and conditions under which the service provider may use the depository institution's eligibility information to market the insurance company's products and services to the depository institution's consumers. The specific terms and conditions are: A list of affiliated companies (including the insurance company) whose products or services may be marketed to the depository institution's consumers by the service provider; the specific products or types of products that may be marketed to the depository institution's consumers by the service provider; the categories of eligibility information that may be used by the service provider in marketing products or services to the depository institution's consumers; the types or categories of the depository institution's consumers to whom the service provider may market products or services of depository institution affiliates; the number and/or types of marketing communications that the service provider may send to the depository institution's consumers; and the length of time during which the service provider may market the products or services of the depository institution's affiliates to its consumers. The depository institution periodically evaluates the service provider's compliance with these terms and conditions. The insurance company asks the service provider to market insurance products to certain consumers who have deposit accounts with the depository institution. Without using the depository institution's eligibility information, the insurance company develops selection criteria and provides those criteria, marketing materials, and related instructions to the service provider. The service provider uses the depository institution's eligibility information from the common database to identify the depository institution's consumers to whom insurance products will be marketed. When the insurance company's marketing materials are provided to the identified consumers, the name of the depository institution is displayed on the insurance marketing materials, an introductory letter that accompanies the marketing materials, an account statement that accompanies the marketing materials, or the envelope containing the marketing materials. The requirements of paragraph (b)(5) of this section have been satisfied, and the insurance company has not made a solicitation to the consumer.

(vi) The same facts as in the example in paragraph (b)(6)(v) of this section, except that the terms and conditions permit the service provider to use the depository institution's eligibility information to market the products and services of other affiliates to the depository institution's consumers whenever the service provider deems it appropriate to do so. The service provider uses the depository institution's eligibility information in accordance with the discretion afforded to it by the terms and conditions. Because the terms and conditions are not specific, the requirements of paragraph (b)(5) of this section have not been satisfied.

(c) *Exceptions.* The provisions of this subpart do not apply to you if you use eligibility information that you receive from an affiliate:

(1) To make a solicitation for marketing purposes to a consumer with whom you have a pre-existing business relationship;

(2) To facilitate communications to an individual for whose benefit you provide employee benefit or other services pursuant to a contract with an employer related to and arising out of the current employment relationship or status of the individual as a participant or beneficiary of an employee benefit plan;

(3) To perform services on behalf of an affiliate, except that this subparagraph shall not be construed as permitting you to send solicitations on behalf of an affiliate if the affiliate would not be permitted to send the solicitation as a result of the election of the consumer to opt out under this subpart;

(4) In response to a communication about your products or services initiated by the consumer;

(5) In response to an authorization or request by the consumer to receive solicitations; or

(6) If your compliance with this subpart would prevent you from complying with any provision of State insurance laws pertaining to unfair discrimination in any State in which you are lawfully doing business.

(d) *Examples of exceptions* —(1) *Example of the pre-existing business relationship exception.* A consumer has a deposit account with a depository institution. The consumer also has a relationship with the depository institution's securities affiliate for management of the consumer's securities portfolio. The depository institution receives eligibility information about the consumer from its securities affiliate and

Copyright © 2009 Association of Corporate Counsel

uses that information to make a solicitation to the consumer about the depository institution's wealth management services. The depository institution may make this solicitation even if the consumer has not been given a notice and opportunity to opt out because the depository institution has a pre-existing business relationship with the consumer.

(2) *Examples of service provider exception.* (i) A consumer has an insurance policy issued by an insurance company. The insurance company furnishes eligibility information about the consumer to its affiliated depository institution. Based on that eligibility information, the depository institution wants to make a solicitation to the consumer about its deposit products. The depository institution does not have a pre-existing business relationship with the consumer and none of the other exceptions in paragraph (c) of this section apply. The consumer has been given an opt-out notice and has elected to opt out of receiving such solicitations. The depository institution asks a service provider to send the solicitation to the consumer on its behalf. The service provider may not send the solicitation on behalf of the depository institution because, as a result of the consumer's opt-out election, the depository institution is not permitted to make the solicitation.

(ii) The same facts as in paragraph (d)(2)(i) of this section, except the consumer has been given an opt-out notice, but has not elected to opt out. The depository institution asks a service provider to send the solicitation to the consumer on its behalf. The service provider may send the solicitation on behalf of the depository institution because, as a result of the consumer's not opting out, the depository institution is permitted to make the solicitation.

(3) *Examples of consumer-initiated communications.* (i) A consumer who has a deposit account with a depository institution initiates a communication with the depository institution's credit card affiliate to request information about a credit card. The credit card affiliate may use eligibility information about the consumer it obtains from the depository institution or any other affiliate to make solicitations regarding credit card products in response to the consumer-initiated communication.

(ii) A consumer who has a deposit account with a depository institution contacts the institution to request information about how to save and invest for a child's college education without specifying the type of product in which the consumer may be interested. Information about a range of different products or services offered by the depository institution and one or more affiliates of the institution may be responsive to that communication. Such products or services may include the following: Mutual funds offered by the institution's mutual fund affiliate; section 529 plans offered by the institution, its mutual fund affiliate, or another securities affiliate; or trust services offered by a different financial institution in the affiliated group. Any affiliate offering investment products or services that would be responsive to the consumer's request for information about saving and investing for a child's college education may use eligibility information to make solicitations to the consumer in response to this communication.

(iii) A credit card issuer makes a marketing call to the consumer without using eligibility information received from an affiliate. The issuer leaves a voice-mail message that invites the consumer to call a toll-free number to apply for the issuer's credit card. If the consumer calls the toll-free number to inquire about the credit card, the call is a consumer-initiated communication about a product or service and the credit card issuer may now use eligibility information it receives from its affiliates to make solicitations to the consumer.

(iv) A consumer calls a depository institution to ask about retail locations and hours, but does not request information about products or services. The institution may not use eligibility information it receives from an affiliate to make solicitations to the consumer about its products or services because the consumer-initiated communication does not relate to the depository institution's products or services. Thus, the use of eligibility information received from an affiliate would not be responsive to the communication and the exception does not apply.

(v) A consumer calls a depository institution to ask about retail locations and hours. The customer service representative asks the consumer if there is a particular product or service about which the consumer is seeking information. The consumer responds that the consumer wants to stop in and find out about certificates of deposit. The customer service representative offers to provide that information by telephone and mail additional information and application materials to the consumer. The consumer agrees and provides or confirms contact information for receipt of the materials to be mailed. The depository institution may use eligibility information it receives from an affiliate to make solicitations to the consumer about certificates of deposit because such solicitations would respond to the consumer-initiated communication about products or services.

Copyright © 2009 Association of Corporate Counsel

(4) *Examples of consumer authorization or request for solicitations.* (i) A consumer who obtains a mortgage from a mortgage lender authorizes or requests information about homeowner's insurance offered by the mortgage lender's insurance affiliate. Such authorization or request, whether given to the mortgage lender or to the insurance affiliate, would permit the insurance affiliate to use eligibility information about the consumer it obtains from the mortgage lender or any other affiliate to make solicitations to the consumer about homeowner's insurance.

(ii) A consumer completes an online application to apply for a credit card from a credit card issuer. The issuer's online application contains a blank check box that the consumer may check to authorize or request information from the credit card issuer's affiliates. The consumer checks the box. The consumer has authorized or requested solicitations from the card issuer's affiliates.

(iii) A consumer completes an online application to apply for a credit card from a credit card issuer. The issuer's online application contains a pre-selected check box indicating that the consumer authorizes or requests information from the issuer's affiliates. The consumer does not deselect the check box. The consumer has not authorized or requested solicitations from the card issuer's affiliates.

(iv) The terms and conditions of a credit card account agreement contain preprinted boilerplate language stating that by applying to open an account the consumer authorizes or requests to receive solicitations from the credit card issuer's affiliates. The consumer has not authorized or requested solicitations from the card issuer's affiliates.

(e) *Relation to affiliate-sharing notice and opt-out* . Nothing in this subpart limits the responsibility of a person to comply with the notice and opt-out provisions of section 603(d)(2)(A)(iii) of the Act where applicable.

§ 222.22 Scope and duration of opt-out.

(a) *Scope of opt-out* —(1) *In general* . Except as otherwise provided in this section, the consumer's election to opt out prohibits any affiliate covered by the opt-out notice from using eligibility information received from another affiliate as described in the notice to make solicitations to the consumer.

(2) *Continuing relationship* —(i) *In general* . If the consumer establishes a continuing relationship with you or your affiliate, an opt-out notice may apply to eligibility information obtained in connection with—

(A) A single continuing relationship or multiple continuing relationships that the consumer establishes with you or your affiliates, including continuing relationships established subsequent to delivery of the opt-out notice, so long as the notice adequately describes the continuing relationships covered by the opt-out; or

(B) Any other transaction between the consumer and you or your affiliates as described in the notice.

(ii) Examples of continuing relationships. A consumer has a continuing relationship with you or your affiliate if the consumer—

(A) Opens a deposit or investment account with you or your affiliate;

(B) Obtains a loan for which you or your affiliate owns the servicing rights;

(C) Purchases an insurance product from you or your affiliate;

(D) Holds an investment product through you or your affiliate, such as when you act or your affiliate acts as a custodian for securities or for assets in an individual retirement arrangement;

(E) Enters into an agreement or understanding with you or your affiliate whereby you or your affiliate undertakes to arrange or broker a home mortgage loan for the consumer;

(F) Enters into a lease of personal property with you or your affiliate; or

Copyright © 2009 Association of Corporate Counsel

(G) Obtains financial, investment, or economic advisory services from you or your affiliate for a fee.

(3) *No continuing relationship* —(i) *In general* . If there is no continuing relationship between a consumer and you or your affiliate, and you or your affiliate obtain eligibility information about a consumer in connection with a transaction with the consumer, such as an isolated transaction or a credit application that is denied, an opt-out notice provided to the consumer only applies to eligibility information obtained in connection with that transaction.

(ii) *Examples of isolated transactions* . An isolated transaction occurs if–

(A) The consumer uses your or your affiliate's ATM to withdraw cash from an account at another financial institution; or

(B) You or your affiliate sells the consumer a cashier's check or money order, airline tickets, travel insurance, or traveler's checks in isolated transactions.

(4) *Menu of alternatives* . A consumer may be given the opportunity to choose from a menu of alternatives when electing to prohibit solicitations, such as by electing to prohibit solicitations from certain types of affiliates covered by the opt-out notice but not other types of affiliates covered by the notice, electing to prohibit solicitations based on certain types of eligibility information but not other types of eligibility information, or electing to prohibit solicitations by certain methods of delivery but not other methods of delivery. However, one of the alternatives must allow the consumer to prohibit all solicitations from all of the affiliates that are covered by the notice.

(5) *Special rule for a notice following termination of all continuing relationships* —(i) *In general* . A consumer must be given a new opt-out notice if, after all continuing relationships with you or your affiliate(s) are terminated, the consumer subsequently establishes another continuing relationship with you or your affiliate(s) and the consumer's eligibility information is to be used to make a solicitation. The new opt-out notice must apply, at a minimum, to eligibility information obtained in connection with the new continuing relationship. Consistent with paragraph (b) of this section, the consumer's decision not to opt out after receiving the new opt-out notice would not override a prior opt-out election by the consumer that applies to eligibility information obtained in connection with a terminated relationship, regardless of whether the new opt-out notice applies to eligibility information obtained in connection with the terminated relationship.

(ii) *Example* . A consumer has a checking account with a depository institution that is part of an affiliated group. The consumer closes the checking account. One year after closing the checking account, the consumer opens a savings account with the same depository institution. The consumer must be given a new notice and opportunity to opt out before the depository institution's affiliates may make solicitations to the consumer using eligibility information obtained by the depository institution in connection with the new savings account relationship, regardless of whether the consumer opted out in connection with the checking account.

(b) *Duration of opt-out* . The election of a consumer to opt out must be effective for a period of at least five years (the "opt-out period") beginning when the consumer's opt-out election is received and implemented, unless the consumer subsequently revokes the opt-out in writing or, if the consumer agrees, electronically. An opt-out period of more than five years may be established, including an opt-out period that does not expire unless revoked by the consumer.

(c) *Time of opt-out* . A consumer may opt out at any time.

§ 222.23 Contents of opt-out notice; consolidated and equivalent notices.

(a) *Contents of opt-out notice* —(1) *In general* . A notice must be clear, conspicuous, and concise, and must accurately disclose:

(i) The name of the affiliate(s) providing the notice. If the notice is provided jointly by multiple affiliates and each affiliate shares a common name, such as "ABC," then the notice may indicate that it is being provided by multiple companies with the ABC name or multiple companies in the ABC group or family of companies, for example, by stating that the notice is provided by "all of the ABC companies," "the ABC banking, credit card, insurance, and securities companies," or by listing the name of each affiliate

Copyright © 2009 Association of Corporate Counsel

providing the notice. But if the affiliates providing the joint notice do not all share a common name, then the notice must either separately identify each affiliate by name or identify each of the common names used by those affiliates, for example, by stating that the notice is provided by "all of the ABC and XYZ companies" or by "the ABC banking and credit card companies and the XYZ insurance companies";

(ii) A list of the affiliates or types of affiliates whose use of eligibility information is covered by the notice, which may include companies that become affiliates after the notice is provided to the consumer. If each affiliate covered by the notice shares a common name, such as "ABC," then the notice may indicate that it applies to multiple companies with the ABC name or multiple companies in the ABC group or family of companies, for example, by stating that the notice is provided by "all of the ABC companies," "the ABC banking, credit card, insurance, and securities companies," or by listing the name of each affiliate providing the notice. But if the affiliates covered by the notice do not all share a common name, then the notice must either separately identify each covered affiliate by name or identify each of the common names used by those affiliates, for example, by stating that the notice applies to "all of the ABC and XYZ companies" or to "the ABC banking and credit card companies and the XYZ insurance companies";

(iii) A general description of the types of eligibility information that may be used to make solicitations to the consumer;

(iv) That the consumer may elect to limit the use of eligibility information to make solicitations to the consumer;

(v) That the consumer's election will apply for the specified period of time stated in the notice and, if applicable, that the consumer will be allowed to renew the election once that period expires;

(vi) If the notice is provided to consumers who may have previously opted out, such as if a notice is provided to consumers annually, that the consumer who has chosen to limit solicitations does not need to act again until the consumer receives a renewal notice; and

(vii) A reasonable and simple method for the consumer to opt out.

(2) *Joint relationships* . (i) If two or more consumers jointly obtain a product or service, a single opt-out notice may be provided to the joint consumers. Any of the joint consumers may exercise the right to opt out.

(ii) The opt-out notice must explain how an opt-out direction by a joint consumer will be treated. An opt-out direction by a joint consumer may be treated as applying to all of the associated joint consumers, or each joint consumer may be permitted to opt out separately. If each joint consumer is permitted to opt out separately, one of the joint consumers must be permitted to opt out on behalf of all of the joint consumers and the joint consumers must be permitted to exercise their separate rights to opt out in a single response.

(iii) It is impermissible to require *all* joint consumers to opt out before implementing *any* opt-out direction.

(3) *Alternative contents* . If the consumer is afforded a broader right to opt out of receiving marketing than is required by this subpart, the requirements of this section may be satisfied by providing the consumer with a clear, conspicuous, and concise notice that accurately discloses the consumer's opt-out rights.

(4) *Model notices* . Model notices are provided in appendix C of this part.

(b) *Coordinated and consolidated notices* . A notice required by this subpart may be coordinated and consolidated with any other notice or disclosure required to be issued under any other provision of law by the entity providing the notice, including but not limited to the notice described in section 603(d)(2)(A)(iii) of the Act and the Gramm-Leach-Bliley Act privacy notice.

(c) *Equivalent notices* . A notice or other disclosure that is equivalent to the notice required by this subpart, and that is provided to a consumer together with disclosures required by any other provision of law, satisfies the requirements of this section.

Copyright © 2009 Association of Corporate Counsel

§ 222.24 Reasonable opportunity to opt out.

(a) *In general* . You must not use eligibility information about a consumer that you receive from an affiliate to make a solicitation to the consumer about your products or services, unless the consumer is provided a reasonable opportunity to opt out, as required by §222.21(a)(1)(ii) of this part.

(b) *Examples of a reasonable opportunity to opt out* . The consumer is given a reasonable opportunity to opt out if:

(1) *By mail* . The opt-out notice is mailed to the consumer. The consumer is given 30 days from the date the notice is mailed to elect to opt out by any reasonable means.

(2) *By electronic means* . (i) The opt-out notice is provided electronically to the consumer, such as by posting the notice at an Internet Web site at which the consumer has obtained a product or service. The consumer acknowledges receipt of the electronic notice. The consumer is given 30 days after the date the consumer acknowledges receipt to elect to opt out by any reasonable means.

(ii) The opt-out notice is provided to the consumer by e-mail where the consumer has agreed to receive disclosures by e-mail from the person sending the notice. The consumer is given 30 days after the e-mail is sent to elect to opt out by any reasonable means.

(3) *At the time of an electronic transaction* . The opt-out notice is provided to the consumer at the time of an electronic transaction, such as a transaction conducted on an Internet Web site. The consumer is required to decide, as a necessary part of proceeding with the transaction, whether to opt out before completing the transaction. There is a simple process that the consumer may use to opt out at that time using the same mechanism through which the transaction is conducted.

(4) *At the time of an in-person transaction* . The opt-out notice is provided to the consumer in writing at the time of an in-person transaction. The consumer is required to decide, as a necessary part of proceeding with the transaction, whether to opt out before completing the transaction, and is not permitted to complete the transaction without making a choice. There is a simple process that the consumer may use during the course of the in-person transaction to opt out, such as completing a form that requires consumers to write a "yes" or "no" to indicate their opt-out preference or that requires the consumer to check one of two blank check boxes—one that allows consumers to indicate that they want to opt out and one that allows consumers to indicate that they do not want to opt out.

(5) *By including in a privacy notice* . The opt-out notice is included in a Gramm-Leach-Bliley Act privacy notice. The consumer is allowed to exercise the opt-out within a reasonable period of time and in the same manner as the opt-out under that privacy notice.

§ 222.25 Reasonable and simple methods of opting out.

(a) *In general* . You must not use eligibility information about a consumer that you receive from an affiliate to make a solicitation to the consumer about your products or services, unless the consumer is provided a reasonable and simple method to opt out, as required by §222.21(a)(1)(ii) of this part.

(b) *Examples* —(1) *Reasonable and simple opt-out methods* . Reasonable and simple methods for exercising the opt-out right include—

(i) Designating a check-off box in a prominent position on the opt-out form;

(ii) Including a reply form and a self-addressed envelope together with the opt-out notice;

(iii) Providing an electronic means to opt out, such as a form that can be electronically mailed or processed at an Internet Web site, if the consumer agrees to the electronic delivery of information;

(iv) Providing a toll-free telephone number that consumers may call to opt out; or

(v) Allowing consumers to exercise all of their opt-out rights described in a consolidated opt-out notice that includes the privacy opt-out under the Gramm-Leach-Bliley Act, 15 U.S.C. 6801 *et seq.* , the affiliate

Copyright © 2009 Association of Corporate Counsel

sharing opt-out under the Act, and the affiliate marketing opt-out under the Act, by a single method, such as by calling a single toll-free telephone number.

(2) *Opt-out methods that are not reasonable and simple* . Reasonable and simple methods for exercising an opt-out right *do not* include—

(i) Requiring the consumer to write his or her own letter;

(ii) Requiring the consumer to call or write to obtain a form for opting out, rather than including the form with the opt-out notice;

(iii) Requiring the consumer who receives the opt-out notice in electronic form only, such as through posting at an Internet Web site, to opt out solely by paper mail or by visiting a different Web site without providing a link to that site.

(c) *Specific opt-out means* . Each consumer may be required to opt out through a specific means, as long as that means is reasonable and simple for that consumer.

§ 222.26 Delivery of opt-out notices.

(a) *In general* . The opt-out notice must be provided so that each consumer can reasonably be expected to receive actual notice. For opt-out notices provided electronically, the notice may be provided in compliance with either the electronic disclosure provisions in this subpart or the provisions in section 101 of the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. 7001 *et seq*.

(b) *Examples of reasonable expectation of actual notice* . A consumer may reasonably be expected to receive actual notice if the affiliate providing the notice:

(1) Hand-delivers a printed copy of the notice to the consumer;

(2) Mails a printed copy of the notice to the last known mailing address of the consumer;

(3) Provides a notice by e-mail to a consumer who has agreed to receive electronic disclosures by e-mail from the affiliate providing the notice; or

(4) Posts the notice on the Internet Web site at which the consumer obtained a product or service electronically and requires the consumer to acknowledge receipt of the notice.

(c) *Examples of no reasonable expectation of actual notice* . A consumer may *not* reasonably be expected to receive actual notice if the affiliate providing the notice:

(1) Only posts the notice on a sign in a branch or office or generally publishes the notice in a newspaper;

(2) Sends the notice via e-mail to a consumer who has not agreed to receive electronic disclosures by e-mail from the affiliate providing the notice; or

(3) Posts the notice on an Internet Web site without requiring the consumer to acknowledge receipt of the notice.

§ 222.27 Renewal of opt-out.

(a) *Renewal notice and opt-out requirement* —(1) *In general* . After the opt-out period expires, you may not make solicitations based on eligibility information you receive from an affiliate to a consumer who previously opted out, unless:

(i) The consumer has been given a renewal notice that complies with the requirements of this section and §§222.24 through 222.26 of this part, and a reasonable opportunity and a reasonable and simple method to renew the opt-out, and the consumer does not renew the opt-out; or

Copyright © 2009 Association of Corporate Counsel

(ii) An exception in §222.21(c) of this part applies.

(2) *Renewal period* . Each opt-out renewal must be effective for a period of at least five years as provided in §222.22(b) of this part.

(3) *Affiliates who may provide the notice* . The notice required by this paragraph must be provided:

(i) By the affiliate that provided the previous opt-out notice, or its successor; or

(ii) As part of a joint renewal notice from two or more members of an affiliated group of companies, or their successors, that jointly provided the previous opt-out notice.

(b) *Contents of renewal notice* . The renewal notice must be clear, conspicuous, and concise, and must accurately disclose:

(1) The name of the affiliate(s) providing the notice. If the notice is provided jointly by multiple affiliates and each affiliate shares a common name, such as "ABC," then the notice may indicate that it is being provided by multiple companies with the ABC name or multiple companies in the ABC group or family of companies, for example, by stating that the notice is provided by "all of the ABC companies," "the ABC banking, credit card, insurance, and securities companies," or by listing the name of each affiliate providing the notice. But if the affiliates providing the joint notice do not all share a common name, then the notice must either separately identify each affiliate by name or identify each of the common names used by those affiliates, for example, by stating that the notice is provided by "all of the ABC and XYZ companies" or by "the ABC banking and credit card companies and the XYZ insurance companies";

(2) A list of the affiliates or types of affiliates whose use of eligibility information is covered by the notice, which may include companies that become affiliates after the notice is provided to the consumer. If each affiliate covered by the notice shares a common name, such as "ABC," then the notice may indicate that it applies to multiple companies with the ABC name or multiple companies in the ABC group or family of companies, for example, by stating that the notice is provided by "all of the ABC companies," "the ABC banking, credit card, insurance, and securities companies," or by listing the name of each affiliate providing the notice. But if the affiliates covered by the notice do not all share a common name, then the notice must either separately identify each covered affiliate by name or identify each of the common names used by those affiliates, for example, by stating that the notice applies to "all of the ABC and XYZ companies" or to "the ABC banking and credit card companies and the XYZ insurance companies";

(3) A general description of the types of eligibility information that may be used to make solicitations to the consumer;

(4) That the consumer previously elected to limit the use of certain information to make solicitations to the consumer;

(5) That the consumer's election has expired or is about to expire;

(6) That the consumer may elect to renew the consumer's previous election;

(7) If applicable, that the consumer's election to renew will apply for the specified period of time stated in the notice and that the consumer will be allowed to renew the election once that period expires; and

(8) A reasonable and simple method for the consumer to opt out.

(c) *Timing of the renewal notice.* —(1) *In general.* A renewal notice may be provided to the consumer either—

(i) A reasonable period of time before the expiration of the opt-out period; or

(ii) Any time after the expiration of the opt-out period but before solicitations that would have been prohibited by the expired opt-out are made to the consumer.

Copyright © 2009 Association of Corporate Counsel

(2) *Combination with annual privacy notice.* If you provide an annual privacy notice under the Gramm-Leach-Bliley Act, 15 U.S.C. 6801 *et seq.* , providing a renewal notice with the last annual privacy notice provided to the consumer before expiration of the opt-out period is a reasonable period of time before expiration of the opt-out in all cases.

(d) *No effect on opt-out period.* An opt-out period may not be shortened by sending a renewal notice to the consumer before expiration of the opt-out period, even if the consumer does not renew the opt out.

§ 222.28 Effective date, compliance date, and prospective application.

(a) *Effective date.* This subpart is effective January 1, 2008.

(b) *Mandatory compliance date.* Compliance with this subpart is required not later than October 1, 2008.

(c) *Prospective application.* The provisions of this subpart shall not prohibit you from using eligibility information that you receive from an affiliate to make solicitations to a consumer if you receive such information prior to October 1, 2008. For purposes of this section, you are deemed to receive eligibility information when such information is placed into a common database and is accessible by you.

Browse Previous | Browse Next

For questions or comments regarding e-CFR editorial content, features, or design, email ecfr@nara.gov.

For questions concerning e-CFR programming and delivery issues, email webteam@gpo.gov.

Section 508 / Accessibility

Joint Release

Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
National Credit Union Administration
Office of the Comptroller of the Currency
Office of Thrift Supervision
Farm Credit Administration

For Immediate Release July 21, 2009

Agencies Release Revisions to Interagency Questions and Answers and Proposed New Questions Regarding Flood Insurance

WASHINGTON — The federal bank, thrift, credit union, and Farm Credit System regulatory agencies today released revised interagency questions and answers regarding flood insurance and requested public comment on several new ones.

The *Interagency Questions and Answers Regarding Flood Insurance (2009)* supersedes the 1997 interagency questions and answers document and supplements other guidance or interpretations issued by the agencies and the Federal Emergency Management Agency (FEMA). The *Interagency Questions and Answers Regarding Flood Insurance (2009)* consists of 77 questions and answers, which were revised based in part on comments received during the public comment period.

The agencies are also proposing for public comment five new questions and answers on determining insurable value in calculating the maximum limit of coverage available for the particular type of property and the timing of force placement of required flood insurance by lenders. After receiving and considering public comment on the five new proposed questions and answers, the agencies intend to incorporate them into the *Interagency Questions and Answers Regarding Flood Insurance (2009)*.

The Federal Deposit Insurance Corporation, Federal Reserve Board, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision, and Farm Credit Administration invite comment on the five proposed questions and answers and, more generally, on other issues and concerns regarding compliance with the federal flood insurance statutes and regulations. Comments specific to the proposed questions and answers regarding determination of insurable value and force placement of required flood insurance are requested by September 21, 2009.

The *Federal Register* notice is attached with instructions on how to submit comments.

FDIC-PR-127-2009

Copyright © 2009 Association of Corporate Counsel

ACC Extras

Supplemental resources available on www.acc.com

Financial Services Regulatory Reform and Modernization.
InfoPak. September 2009
http://www.acc.com/infopaks

Bank Finance and Regulation.
Survey. April 2007
http://www.acc.com/legalresources/resource.cfm?show=16289

Please note, these additional resources are provided by the Association of Corporate Counsel and not by the faculty of this session.

Copyright © 2009 Association of Corporate Counsel