

Strategies for Avoiding Consumer Protection and CRA Pitfalls

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Overview: Recent Developments in Consumer Protection and CRA

- Managing Third Party Arrangements
- FTC Section 5 Unfair and/or Deceptive
- Consumer Complaints
- RESPA Section 8
- Flood Insurance
- CRA

Definition of Pitfall

- An unsuspected Difficulty or Danger
- A Factor Causing Trouble in Achieving a Positive Result
- A Trap in the Form of a Concealed Pit, Designed to Catch Men or Wild Animals [Old English]

Third Party Arrangements

- Includes Subsidiaries, Institution-Affiliated Parties and Third-Party Contractors
- All Entities That Have Entered into a Business Relationship With the Bank
- Weaknesses in Monitoring This Area are a Common Feature in Section 5 Violations That Examiners Have Identified

Common Third Party Relationships

- Perform Functions on a Bank's Behalf
- Provide Access to Products and Services Outside the Bank
- Vendors that Market Processes and Activities
- Use the Bank's Charter or Legal Powers

Third Party Relationship Pitfalls

- Using a Rent-a-bin Relationship and not Monitoring How a Third Party is Managing the Relationship
- Rent A Bin/Credit Card Operation, Where Significant UDAP Violations are Cited
- IT Vendor Security Breach
- Broker/Appraiser Fraud

Strategies for Third Parties

- Analyze Risk and Whether Outsourcing is Appropriate
- Conduct Thorough Due Diligence
- Document Relationship Through Contracts
- Board Approval and Legal Counsel Review
- **BOTTOM LINE:** Management Needs to Monitor the Third Party and the Activity

Resources for Managing Third Party Arrangements

- FDIC Supervisory Insights Summer 2007– Third Party Arrangements Elevating Risk Awareness
http://www.fdic.gov/regulations/examinations/supervisory/insights/sisum07/article01_third-party.html
- FDIC FIL 44-2008- Guidance for Managing Third Party Risk
<http://www.fdic.gov/news/news/financial/2008/fil08044.html>
- FDIC Compliance Examination Handbook, “Compliance Examinations,” Sections II, V, VII, and IX,
www.fdic.gov/regulations/compliance/handbook/html/index.html.

Section 5 of the FTC Act - Unfair and/or Deceptive Acts or Practices

- Applies to all Products and Services Offered by a Financial Institution, Directly or Indirectly
- Applies to Every Stage – Product Development to Rollout, Servicing and Collections
- Violation Could Adversely Affect Compliance and CRA Ratings – Result in an Enforcement Action, Civil Money Penalty, and Restitution

Examples of Section 5 Violations

- Deceptive Advertising
- Increasing Interest Rates for Credit Card Accounts Without Full Disclosure or Advance Notice (14 days)
- Bounce protection: Single Account Balance on ATM Screens and Internet Banking Statements With Consumer's Actual Balance Plus the Amount of Overdraft Protection
- Fee Harvesters: Subprime Cards With Little Credit and High Fees

Example of Fee Harvester Credit Card

Credit Limit \$250

Less: Program Fee \$95

Less: Account Set-Up Fee \$29

Less: Participation Fee \$6 (per month)

Less: Annual Fee \$48

= Total Usable Credit \$72

Section 5 Best Practices

- Review Promotional Materials to Ensure Fair and Adequate Descriptions of Terms, Benefits, and Limitations
- Clearly Disclose Conditions on Terms, Expiration Dates, Conditions for Canceling Service, and Provisions that Permit Changes in Terms
- Disclose Limits or Conditions for “Pre-Approved” Offers and if Approved Terms are Less Favorable
- Tailor Disclosures and Promotional Materials to Sophistication and Experience of Target Group
- Inform Consumers About Fees, Penalties, and Other Charges Imposed, and Reasons for Imposition

Section 5 Best Practices (Continued)

- Follow the 4 P's for Disclosures/Advertising
- PROMINENCE: Is the Font Big Enough for Consumers to Notice and Read?
- PRESENTATION: Is Wording and Format Easy for Consumers to Understand?
- PLACEMENT: Is it Located Where Consumers Will Look?
- PROXIMITY: Is it Near the Claim it Qualifies?

Section 5 Resources

- Supervisory Insights: Chasing the Asterisk: A Field Guide to Caveats, Exceptions, Material Misrepresentations, and Other Unfair or Deceptive Acts or Practices – Winter 2006
<http://www.fdic.gov/regulations/examinations/supervisory/insights/siwin06/siwin06.pdf>
- From the Examiner's Desk Unfair and Deceptive Acts and Practices – Winter 2008
http://www.fdic.gov/regulations/examinations/supervisory/insights/siwin08/unfair_acts.html
- Financial Institution Letters: Unfair or Deceptive Acts or Practices by State-Chartered Banks
<http://www.fdic.gov/news/news/financial/2004/fil2604.html>
<http://www.fdic.gov/news/news/financial/2002/fil0257.html>

Consumer Complaints

- Examiners Review at Every Compliance Examination
- Consumer Complaints are Often a Key Source of Information on Possible UDAPs
- Weaknesses in Compliance Elements in Bank's Overall Program
- Early Warning System

Best Practices for Consumer Complaints

- Develop Centralized System to Process Complaints Received
- Make Compliance Officer Aware of the Complaints
- Act to Ensure a Timely Resolution
- Determine the Cause of the Complaint
- Improve the Institution's Business Practices, as Appropriate
- Include Consumer Complaints in Internal Audits
- Monitor for Trends

RESPA Section 8

- Noticeable Increase in Violations
- Types of Section 8 RESPA Violations Cited
- Compliance Management System Weaknesses
- Resources

Types of Section 8 Violations

- Lender Payments to Mortgage Brokers
- Sham Controlled Business Arrangements
- Joint Advertising
- Marketing Fees Paid by Banks to Developers
- Kickbacks

Note: List is not exhaustive

For Additional Examples Please Refer to FIL-103-99: Potential Violations of RESPA

<http://www.fdic.gov/news/news/financial/1999/fil99103.html>

Lender Payments to Mortgage Brokers

- Banks acting as a Mortgage Broker Accepted Unearned Fees
 - Referred Customers and Accepted a Fee Without Providing Settlement Services
 - Referred Customers, Accepted a Fee, but Provided Only Counseling Type Settlement Services (Steering)
- Must Earn the Fee – Watch Out for Steering
- Please Refer to RESPA Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers

Sham Controlled Business Arrangements

- Sham Joint Venture With a Real Estate Firm
- Joint Ventures Must not be Sham Entities Set Up to Compensate a Person for the Referral of Federally Related Mortgage Loans
- Joint Ventures Must be Real Businesses - HUD Will Apply a 10 Point Test
- Please Refer to HUD Policy Statements

Joint Advertising

- Joint Advertisement Between Mortgage Loan Officers and Realtors or Builders
- Examples Include
 - Links on Bank Websites with Endorsements
 - Joint Real Estate Brochures

Marketing Fees To Builders

- Concerns Include:
 - Fees Based on Potential Mortgage Loan Volume
 - Exclusivity in the Contract
- Arrangements Will Generate Significant Regulatory Scrutiny
- Use Caution: Engage Legal Counsel

Kickbacks

No Diminimus Rule

- Mortgage Loan Officers Accepting Items in Return for Title Orders
- Mortgage Loan Officers Paying For Realtor Open House Expenses
- Mortgage Loan Officers Providing Gift Cards for Referrals

Compliance Management System Weaknesses

- Lack of Knowledge of RESPA Section 8 Requirements – Training Needed at All Levels
- Weak Board and Senior Management Oversight - Failing to Stay Abreast of the Activities of all Business Units
- Lack of Compliance Audit Coverage and Monitoring for Potential RESPA Section 8 Issues

RESPA Section 8 Resources

- RESPA Statement of Policy 1996-2 Policy Statement on Sham Controlled Business Arrangements
<http://www.hud.gov/offices/hsg/sfh/res/res0607c.cfm>
- RESPA Statement of Policy 1996-3 Rental of Office Space, Lock-outs, and Retaliation
<http://www.hud.gov/offices/hsg/sfh/res/res0607b.cfm>
- RESPA Statement of Policy 1999-1 Lender Payments to Mortgage Brokers
<http://www.hud.gov/offices/hsg/sfh/res/resp0222.cfm>
- RESPA Statement of Policy 2001-1 Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers
<http://www.hud.gov/offices/hsg/sfh/res/respapol.cfm>
- FIL-103-99, Potential Violations of Section 8 of the Real Estate Settlement Procedures Act
<http://www.fdic.gov/news/news/financial/1999/fil99103.html>

Flood Insurance

- Flood Insurance Violations Continue
- Flood Insurance Civil Money Penalties Still Being Regularly Assessed
- Effective Compliance Management Tools

Problem Areas

- No Flood Insurance at Origination
- Insufficient Flood Insurance Coverage
- Flood Insurance Notice Not Timely
- Lapse in Flood Insurance Coverage
- Failure to Provide Flood Notice

Effective Compliance Management Tools

Centralized Funding Controls

- Proof of Insurance Coverage
- Verify Coverage Amount
- Proof of Flood Insurance Notice
- Proof of Notice Timing

Prior to Closing

CRA Examination Issues

- Problems Relate to Community Development
- Performance Criteria
- Management Weaknesses
- Strategies & Best Practices
- Impact of Illegal Credit Practices
- Resources

ISB Performance Criteria

- Small Bank Lending Test
- Community Development Test
 - CD Lending
 - CD Investments
 - CD Services

Must Pass Both Tests

Large Bank Performance Criteria

Large Bank

- Lending Test
- Investment Test
- Service Test

Community Development is Included in Each Test and Points are Assigned for Each Rating According to a Matrix

CRA Management Weaknesses

- Lack of Knowledge - Poor Training
- Weak Oversight
 - No Established Goals
 - Lack of Board Involvement
- Failure to Monitor Similarly Situated Banks
- Poor Self Assessments

Best Practices and Strategies

- Train Personnel - Create Specialists
- Engage Line Officers and the Board (Oversight)
- Establish Goals - Proactive Oversight
- Monitor Similarly Situated Banks - Quantitative Study
- Perform Effective Self-Assessments
- Strategies Related to the New Q&A 12(h)(3) - ISBs

CRA Resources

- New CRA Interagency Questions & Answers
<http://www.ffiec.gov/cra/qnadoc.htm>
- Interagency examination procedures
http://www.ffiec.gov/cra/examinations.htm#EX_PROCEDURES
- CRA Public Evaluations
<http://www2.fdic.gov/crapes/>
- Listing of distressed and underserved geographies
<http://www.ffiec.gov/cra/examinations.htm#UDGEO>
- FEMA disaster areas
http://www.fema.gov/news/disaster_totals_annual.fema

Impact of Illegal Credit Practices

Examples Include:

- Fair Lending - ECOA & Fair Housing
Note: Discretion in Pricing is a Red Flag
- RESPA Section 8
- Regulation Z - High Cost Mortgages
- Regulation Z - Right of Rescission
- FTC Section 5 - UDAP

Q & A Session



QUESTIONS?

Further Questions? Contact your local Field Review Examiner

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Thank You for Participating

We Hope This Discussion Will Help you Avoid Compliance Pitfalls

