

CONSUMER COMPLIANCE OUTLOOK®

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A FEDERAL RESERVE SYSTEM
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SERVICEMEMBER FINANCIAL PROTECTION WEBINAR: QUESTIONS AND ANSWERS

BY LANETTE MEISTER, SENIOR SUPERVISORY CONSUMER FINANCIAL SERVICES ANALYST, FEDERAL RESERVE BOARD; LAURIE MAGGIANO, DIRECTOR OF POLICY, OFFICE OF HOMEOWNERSHIP PRESERVATION, U.S. TREASURY; AND LAURA ARCE, POLICY ANALYST, OFFICE OF HOUSING AND REGULATORY POLICY, FEDERAL HOUSING FINANCE AGENCY

Editor's note: Effective December 1, 2015, the Office of the Law Revision Counsel of the United States House of Representatives eliminated the appendix to title 50, where the Servicemembers Civil Relief Act (SCRA) was codified as 50 U.S.C. App. §§ 501-597b, and recodified it as 50 U.S.C. §§ 3901-4043 et seq. Accordingly, we have updated the SCRA cites in the article to reflect this. We also updated the link to the Department of Defense SCRA website to verify if someone is an active member of the military. Finally, for clarity, we made a technical correction to the answer to Question 7.

On September 10, 2012, the Federal Reserve System hosted an interagency *Outlook Live* webinar titled "Servicemember Financial Protection."* Participants submitted a significant number of questions before and during the session. Because of time constraints, only a limited number of those questions were answered during the webcast. This article addresses the most common questions received. Representatives from the Federal Reserve Board, the Federal Housing Finance Agency, and the U.S. Department of the Treasury provided responses to questions regarding their agencies' programs.

RESPONSES FROM THE FEDERAL RESERVE BOARD

Notification of Active Duty

1. If a service member does not notify a financial institution of active duty until several months after he or she receives orders from the military, does this institution need to go back to the original date of the orders, or make the maximum 6 percent effective as of the date it receives notification?

The reduction in the interest rate and the adjustment of the periodic payments under section 3937 of the Servicemembers Civil Relief Act (SCRA) should be effective as of the date on which the service member is called to active duty. The service member has up to 180 days after the date of his or her release from military service to provide this notification.

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* The webinar has been archived and is available at: <http://tinyurl.com/scra-webinar>.

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2012 YEAR IN REVIEW WEBINAR: QUESTIONS AND ANSWERS

BY KENNETH BENTON, SENIOR CONSUMER REGULATIONS SPECIALIST,
FEDERAL RESERVE BANK OF PHILADELPHIA

On December 4, 2012, the Federal Reserve System conducted an *Outlook Live* webinar titled “Consumer Compliance Hot Topics — 2012 Year in Review.”¹ We received a significant number of questions during the event and were not able to address all of them. This article answers the most frequently asked questions concerning the Consumer Financial Protection Bureau’s (CFPB) remittance transfer rulemaking and the Biggert-Waters Flood Insurance Reform Act of 2012.

REMITTANCE TRANSFER RULE

1. Does the 100 remittance transfers per year safe harbor provision apply only to transfers that exceed \$15 or the total number of transfers regardless of the amount?

The final rule applies to remittance transfer providers, who are defined in 12 C.F.R. §1005.30(f)(1) as persons providing remittance transfers to consumers in the normal course of business. To facilitate compliance, the final rule includes a safe harbor provision that states that providers who conducted 100 or fewer remittance transfers in the previous calendar year and who continue to make 100 or fewer remittance transfers in the current year are deemed to not be providing remittance transfers in the normal course of business. “Remittance transfer” is defined in 12 C.F.R. §1005.30(e) as an electronic transfer of funds conducted by a remittance transfer provider at the request of a sender to a designated recipient. Under 12 C.F.R. §1005.30(e)(2) (i), transfers in the amount of \$15 or less are specifically excluded from the definition of “remittance transfer.” Therefore, only transfers that exceed \$15 count toward the 100 safe-harbor threshold. In addition, the CFPB’s *International Fund Transfers Small Entity Compliance Guide* states that “[w]hen counting to 100, you need to count all types of remittance transfers covered by the rule together” (emphasis added). See *Compliance Guide*, p. 12.²

Note: On January 29, 2013, the CFPB issued a final rule delaying the February 7, 2013, effective date for the remittance transfer rule. See 78 Fed. Reg. 6,025 (Jan. 29, 2013). The effective date was delayed because the CFPB issued a rulemaking proposal on December 31, 2012, to amend the final rule. See 77 Fed. Reg. 77, 188 (Dec. 21, 2012). When the proposal is made final, a new effective date will be announced.

2. Does the 100 remittance transfers per year safe harbor apply to all foreign wires or just consumer wires to foreign countries?

¹ The webinar has been archived and is available for replay at: <http://tinyurl.com/year-review-2012>.

² The *Compliance Guide* is available at: <http://tinyurl.com/remittance-guide>.

As discussed in Q&A 1, only transfers that are “remittance transfers” under the regulatory definition should be counted in determining whether a person is within the safe harbor threshold. A “remittance transfer” is defined in 12 C.F.R. §1005.30(e) as an electronic transfer of funds conducted by a remittance transfer provider at the request of a sender to a designated recipient. A “sender” is defined in 12 C.F.R. §1005.30(g) as “a consumer in a State who primarily for personal, family, or household purposes requests a remittance transfer provider to send a remittance transfer to a designated recipient” (emphasis added). Therefore, consumer to business foreign wires are considered “remittance transfers” (see Q&A 4 below), but business to business foreign wires are *not* and should not be counted when determining whether a person meets the 100 remittance transfers safe harbor.

3. If we do not provide more than 100 remittance transfers a year, are we required to provide error resolution rights as well as cancellation and refund rights?

If you conducted 100 or fewer remittance transfers in the previous calendar year and in the current year, you are not a remittance transfer provider subject to the remittance transfer provisions of Regulation E (subpart B). See 12 C.F.R. §1005.30(f)(2). Therefore, you would not be subject to 12 C.F.R. §1005.33 (error resolution for remittance transfers) or 12 C.F.R. §1005.34 (cancellation and refund). However, the Regulation E error resolution procedures for electronic fund transfers, as described in 12 C.F.R. §1005.11, may still apply. For example, if a consumer alleged that a remittance transfer that was also an electronic fund transfer was made from the consumer’s checking account in the total amount of \$1,000, but the consumer’s account was erroneously charged \$1,500, the account-holding financial institution would have to investigate following the procedure specified in 12 C.F.R. §1005.11, even if the financial institution was not a remittance transfer provider subject to the remittance transfer provisions. *Outlook* published an article on these procedures in the Fourth Quarter 2012 issue.³ In addition, requirements under state law may also apply.

³ “Error Resolution Procedures and Consumer Liability Limits for Unauthorized Electronic Fund Transfers,” *Outlook* (Fourth Quarter 2012); available at: <http://tinyurl.com/error-resolution>.

4. Is it true that this rule applies only to consumers and not businesses?

The rule only applies when a sender is a consumer. See 12 C.F.R. §1005.30(g). However, comment 30(c)–1 states that a designated recipient can be either a natural person or an organization, such as a corporation. Therefore, remittance transfers covered under the rule include transfers from a consumer to a business.

5. How do you provide “proof of payment” when using the combined disclosure for remittance transfers when the actual payment is a debit from the customer’s account conducted after the customer has left the branch? This is currently done by our wire room after the entities go through our screening processes.

When a transfer is scheduled in advance, the regulation and commentary allow the provider to provide proof of *scheduling* in lieu of proof of payment. Comment 31(b)(3)-2 states: “Where a transfer (whether a one-time remittance transfer or the first in a series of preauthorized remittance transfers) is scheduled before the date of transfer and the provider does not intend to process payment until at or near the date of transfer, *the provider may provide a confirmation of scheduling in lieu of the proof of payment required by §1005.31(b)(3)(i). No further proof of payment is required when payment is later processed*” (emphasis added). The confirmation of scheduling “must be clear and conspicuous, provided in writing or electronically, and provided in a retainable form.” See 12 C.F.R. §1005.31(b)(3)(ii).

6. Explain the changes to Regulation J and to the rules for the Clearing House Interbank Payments System (CHIPS) to address the Uniform Commercial Code (UCC) Article 4-A issue for remittance transfers.

Section 4-A-108 of the UCC specifies that UCC Article 4-A does not apply to any transaction subject to the Electronic Fund Transfer Act (EFTA). The Dodd-Frank Wall Street Reform and Consumer Protection Act amends the EFTA to add consumer protection requirements for foreign remittance transfers in new EFTA section 919, 15 U.S.C. §1693o-1. Therefore, Article 4-A would not apply to a consumer foreign remittance transfer subject to EFTA 919 and its implementing regulation (subpart B of Regulation E, 12 C.F.R. §§1005.30-

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CREDIT CARD ACT REQUIREMENTS FOR GIFT CERTIFICATES, STORE GIFT CARDS, AND GENERAL-USE PREPAID CARDS

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THE CREDIT CARD ACT

On May 22, 2009, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act)¹ was signed into law. While the law's title suggests that it only applies to credit cards, the law also created new consumer protections for gift certificates, store gift cards, and general-use prepaid cards through amendments to the Electronic Fund Transfer Act (EFTA).² Specifically, section 401 of the Credit CARD Act requires disclosures for gift certificates, store gift cards, or general-use prepaid cards fees and expiration dates; limits dormancy, inactivity, and service fees for these cards and certificates; and establishes a minimum period of five years before the underlying funds for these cards and certificates can expire. Section 401 also excludes certain gift certificates, store gift cards, or general-use prepaid cards from these requirements. Section 402 of the Credit CARD Act amends the EFTA to provide that the EFTA does not preempt any state laws that address dormancy, inactivity, or service fees, or expiration dates for gift certificates, store gift cards, or general-use prepaid cards if such state laws provide greater consumer protection than the gift card provisions in the EFTA. The Federal Reserve Board (Board) published a final rule amending Regulation E to implement Sections 401 and 402, which became effective in 2010.³ This article reviews the compliance requirements of the final rule.

BACKGROUND

A gift card is a type of prepaid card (or other elec-

tronic access device) typically purchased by one consumer and given to another as a present or to express appreciation or recognition. Merchants and vendors are increasingly opting to use electronic gift cards instead of paper certificates because of lower costs and because electronic cards are less vulnerable to fraud or counterfeiting.⁴

Gift cards are generally categorized as either closed-loop or open-loop. Closed-loop gift cards, which represent the majority of the gift card market,⁵ are accepted at a single merchant or group of affiliated merchants as payment for goods and services and cannot be reloaded with additional value after issuance. Open-loop gift cards are branded with a payment card processor network such as Visa, MasterCard, American Express, or Discover, and are generally issued by financial institutions. An open-loop card can be used at merchants participating in the payment network and are more likely to be reloadable.⁶

SCOPE OF RULE

The final rule applies to gift certificates, store gift cards, and general-use prepaid cards that are sold or issued primarily for personal, family, or household use.⁷ Gift certificates, store gift cards, and general-use prepaid cards include cards, codes, or other devices issued in a specified amount, regardless of whether they are issued in card form. Therefore, the final rule may apply to an account number or bar code that can access underlying funds; a device with a chip or other

¹ Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734-66

² Electronic Fund Transfer Act, 15 U.S.C. Section 1693 et seq.

³ 75 Fed. Reg. 16580 (Apr. 1, 2010). The regulations became effective on August 22, 2010; however, on July 27, 2010, Congress passed legislation to delay the effective date for certain gift card disclosure provisions until January 31, 2011.

⁴ 75 Fed. Reg. at 16580

⁵ 75 Fed. Reg. at 16580

⁶ 75 Fed. Reg. at 16580-81

⁷ Sections 12 C.F.R §1005.20(a)(1)(i), (2)(i), and (3)(i)

embedded mechanism that links the device to stored funds, such as a mobile phone or sticker containing a contactless chip; or an electronic promise.⁸ An electronic promise means a person's commitment or obligation communicated or stored in electronic form made to a consumer to provide payment for goods or services; for example, a code given as a gift that can be redeemed in an online transaction would be an electronic promise.⁹

EXCLUSIONS

The regulation contains six exclusions from the definitions of gift certificate, store gift card, and general-use prepaid card for certain types of cards, codes, and devices.

Cards Usable Solely for Telephone Services

Cards for telephone services are excluded. However, the final rule interprets telephone services narrowly, so the exclusion does not apply to cards redeemed for prepaid Internet access and similar technology services.¹⁰

Reloadable Cards Not Marketed or Labeled as a Gift Card or Gift Certificate

The term "reloadable" means funds can be added to the card, code, or other device by the consumer or other persons. For compliance purposes, this is determined by the terms and conditions of the prepaid card, rather than by the technical ability of the issuer to add value to the card.¹¹

The Official Staff Commentary (Commentary) to the rule contains a robust discussion of what constitutes "marketed or labeled as a gift card or gift certificate." Cards and certificates are deemed to be marketed or labeled as such if anyone other than the consumer who purchased the card (including the issuer, the retailer, the program manager that may distribute the card, or the payment network on which a card is used) promotes the use of the card as a gift card or gift certificate.¹²

In certain cases, multiple parties may be involved in a card program. For example, a retailer, such as a grocery store or a drug store, may be marketing the product and not the card issuer. Display racks at the retailer may make gift cards available as well as general-purpose reloadable cards and telephone cards; therefore, the retailer is offering both excludable and nonexcludable products. In this case, the card issuer may not always be able to verify how excludable cards are

displayed at each retail outlet to ensure that they are not being marketed as gift cards or gift certificates through signage, advertisements, or otherwise.¹³ Recognizing the compliance risks involved when multiple parties are involved in a card program, the final rule provides that the exclusion applies so long as a certificate or card is not marketed or labeled as a gift card or certificate and if persons subject to the rule maintain policies and procedures reasonably designed to avoid such marketing.¹⁴

The Commentary provides examples of such reasonable policies and procedures, which may include contractual terms and conditions that prohibit the general-purpose reloadable cards from being marketed as a gift card or certificate and controls to regularly monitor or otherwise verify that cards are not being marketed as such.¹⁵ In one specific example in the Commentary, the issuer or program manager sets up a single multi-sided display at the retailer on which a variety of prepaid products are sold. Gift cards are segregated from excluded cards, with gift cards on one side of the display and excluded cards on a different side of the display.¹⁶ Signs of equal prominence clearly differentiate between gift cards and other types of prepaid cards that are available for sale, and the retailer does not use any more conspicuous signage suggesting the general availability of gift cards, such as a large sign stating "Gift Cards" at the top of the display or located near the display. In this case, the exclusion applies because policies and procedures reasonably designed to avoid the marketing of the general-purpose reloadable cards as gift cards or gift certificates are maintained.

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⁸ Comment 20(a)-1

⁹ Comment 20(a)-2

¹⁰ 75 Fed. Reg. at 16592

¹¹ Comment 20(b)(2)-1

¹² Comment 20(b)(2)-2

¹³ 75 Fed. Reg. at 16594

¹⁴ Comment 20(b)(2)-4

¹⁵ Comment 20(b)(2)-4

¹⁶ Comment 20(b)(2)-4.iii

NEWS FROM WASHINGTON: REGULATORY UPDATES*

Consumer Financial Protection Bureau (CFPB) requests information about student cards and bank accounts.

On January 31, 2013, the CFPB launched an initiative to learn more about financial products designed for college students and the impact of agreements that schools often make with financial companies. The CFPB solicited information on a variety of related issues, including: 1) the information schools share with financial institutions when they establish these relationships; 2) how financial products are marketed to students; 3) the fees for the products; 4) the marketing agreements between schools and financial institutions; and 5) student experiences using campus financial products. The CFPB will use the information to determine if the arrangements are in the best interest of students. The comment period ended on March 18, 2013.

CFPB delays effective date of Regulation E foreign remittance transfer rule and proposes three changes to final rule.

On January 22, 2013, the CFPB announced it was delaying the February 7, 2013, effective date for its foreign remittance transfer rule because of a pending rulemaking proposal the CFPB issued in December 2012 that would make three changes to the final rule. The proposal was issued in response to industry concerns about compliance challenges in implementing the final rule. The proposal addresses disclosure of foreign taxes and institution fees, disclosure of sub-national taxes in a foreign country, and liability for errors when a sender provides incorrect or incomplete account information for the recipient. The CFPB will announce the new effective date when it makes the December 2012 proposal final.

Federal Financial Institutions Examination Council (FFIEC) proposes social media guidance.

On January 22, 2013, the FFIEC issued proposed guidance on the application of consumer protection laws and regulations to the social media activities of financial institutions and nonbanks. The guidance does not impose new compliance re-

quirements but instead is intended to help financial institutions and nonbanks recognize and manage the potential risks of using social media. The guidance focuses on three risk categories: compliance and legal risks, including a discussion of specific laws and regulations; reputational risks; and operational risks. The comment period ended on March 25, 2013.

CFPB announces increase in Home Mortgage Disclosure Act asset-size exemption threshold.

On December 28, 2012, the CFPB issued a final rule adjusting the asset-size exemption threshold for banks, savings associations, and credit unions under Regulation C, which implements the Home Mortgage Disclosure Act (HMDA). The asset-size exemption will increase to \$42 million. Institutions with assets of \$42 million or less as of December 31, 2012, are exempt from collecting HMDA data in 2013. However, an exemption from collecting data in 2013 does not affect an institution's obligation to report 2012 data if an institution was subject to HMDA in 2012.

CFPB launches inquiry on the impact of the Credit CARD Act.

On December 19, 2012, the CFPB announced that it is seeking public comment on how the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act) has affected consumers and the credit card industry. In particular, the CFPB sought information about the terms of credit card agreements, the effectiveness of the Credit CARD Act's protections against unfair or deceptive acts or practices, changes in the cost and availability of credit, and the use of risk-based pricing. The CFPB will use the information in a report to Congress on the state of the consumer credit card market. The comment period closed on February 19, 2013.

Banking agencies release annual CRA asset-size threshold adjustments for institutions.

On December 19, 2012, the federal bank regulatory agencies announced the annual adjustment to the asset-size thresholds used to define small bank, small savings association, intermediate small bank, and inter-



mediate small savings association under the Community Reinvestment Act (CRA) regulations as follows:

- “Small bank” or “small savings association” means an institution that, as of December 31 of either of the prior two calendar years, had assets of less than \$1.186 billion.
- “Intermediate small bank” or “intermediate small savings association” means a small institution with assets of at least \$296 million as of December 31 of both of the prior two calendar years, and less than \$1.186 billion as of December 31 of either of the prior two calendar years. The annual adjustments are required by the CRA regulations. Based on the asset-size threshold, financial institutions are evaluated under different CRA examination procedures. Financial institutions meeting the small and intermediate small asset-size threshold are not subject to the reporting requirements applicable to large banks.

The changes were effective January 1, 2013.

CFPB proposes allowing companies to run trial disclosure programs. On December 13, 2012, the CFPB announced its proposed policy to allow companies to test new consumer disclosures on a case-by-case basis, as provided under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The CFPB launched Project Catalyst in November as a part of that commitment, under which the CFPB would approve individual companies, on a case-by-case basis, for limited time exemptions from current federal disclosure laws to allow those companies to research and test informative, cost-effective disclosures and share the results with the CFPB. The information will be used to improve its disclosure rules and model forms. The comment period closed on February 15, 2013.

The Federal Reserve Board (Board) and the CFPB announce inflation adjustments to the dollar thresholds for exempt consumer credit and

lease transactions. On November 20, 2012, the Board and the CFPB announced an increase in the dollar threshold for coverage under Regulations Z and M. Effective January 1, 2013, consumer credit and lease transactions in the amount of \$53,000 or less are subject to Regulations Z and M, respectively. However, private education loans and loans secured by real property (such as mortgages) are subject to Regulation Z regardless of the loan amount.

The CFPB increases the fee trigger for coverage under the Home Ownership Equity Protection Act (HOEPA). On November 20, 2012, the CFPB announced its annual adjustment to the dollar amount of fees that trigger additional disclosure requirements and restrictions under Regulation Z and HOEPA for certain high-cost home mortgage loans. HOEPA's requirements apply when the total points and fees payable by the consumer exceed the fee-based trigger (initially set at \$400 and adjusted annually) or 8 percent of the total loan amount, whichever is larger. The dollar amount of the fee-based trigger has been adjusted to \$625, effective January 1, 2013.

CFPB extends effective date for new mortgage disclosures. On November 16, 2012, the CFPB announced that it will delay the mandatory compliance deadline for certain new mortgage disclosures required under the Dodd-Frank Act until it completes a pending rulemaking proposal to integrate mortgage disclosures required under the Truth in Lending Act and the Real Estate Settlement Procedures Act into a single disclosure. The Dodd-Frank Act established certain new mortgage disclosure requirements, including disclosures about the cancellation of escrow accounts, consumers' liability for debt payment after foreclosure, and the creditor's policy for accepting partial payments. The CFPB is allowing creditors more time to provide these new disclosures until the new integrated mortgage disclosure rulemaking is completed.

* Links to the announcements are available in the online version of *Outlook* at: <http://www.consumercomplianceoutlook.org>.

REGULATION H — NATIONAL FLOOD INSURANCE ACT (NFIA)

The First Circuit allows class-action lawsuit alleging a lender required borrowers to obtain excessive flood insurance. *Lass v. Bank of America, N.A.*, 695 F.3d 129 (1st Cir. 2012), *petition for reh'g en banc denied* (Jan. 3, 2013). Several class-action lawsuits have been filed against banks and servicers alleging that they breached their mortgage agreements and acted in bad faith by requiring borrowers to obtain more flood insurance than is permitted under their mortgage agreements and related documents. One such lawsuit against Bank of America was dismissed by a federal district court in Boston. But on appeal, the First Circuit reversed the dismissal. Bank of America acquired a mortgage from another lender and then sent notice to the borrower that \$145,086 in additional flood insurance coverage was required to cover the replacement cost of the property. When the borrower failed to obtain the additional coverage, the bank force-placed it and charged the borrower's escrow account. The lawsuit alleged that the bank was breaching a "Flood Insurance Notification" provided at loan closing, which specifically stated that flood insurance must be obtained for the loan amount or the maximum amount available, whichever is less (i.e., the amount required under the Flood Disaster Protection Act (FDPA) of 1973). The lower court dismissed the case based on a provision in the mortgage agreement stating that the lender may require the borrower to obtain hazard insurance in the amount specified by the lender. But the First Circuit reversed the dismissal, finding that the language in the mortgage agreement and flood notification was ambiguous as to whether the bank had the authority to require flood insurance coverage in excess of the amount required under the FDPA. The case was remanded for further proceedings, with one judge dissenting.

In another opinion issued on the same day, the First Circuit addressed a similar subject in *Kolbe v. BAC Home Loans Servicing, LP*, 695 F.3d 111 (1st Cir. 2012). In that case, the loan servicer required force-placed insurance in excess of the amount identified in the mortgage agreement for a Federal Housing Administration (FHA) loan. Subsequently, the First Circuit granted the bank's motion to vacate the three-judge panel's decision and have the entire court (en banc) decide the appeal. The case was argued to the en banc court in February 2013.

New York federal court denies motion to dismiss class-action lawsuit alleging borrowers were forced to purchase more flood insurance than permitted under their mortgage agreements. *Casey v. Citibank, N.A.*, ___ F.Supp.2d ___, 2013 WL 11901 (N.D.N.Y. Jan 2. 2013). The two named plaintiffs, Casey and Skinner, alleged that their lenders and loan servicers improperly required them to purchase flood insurance in excess of the amount permitted under their mortgage agreements and that the defendants profited from the forced-placed flood insurance. Casey had a \$25,000 FHA-guaranteed mortgage, which was subsequently sold to Citibank. Casey was later asked to increase the flood insurance coverage by \$107,780. When the loan was sold again, the new lender asked him to increase the coverage to \$237,349 (when the loan balance was less than \$17,000). In both instances, the extra insurance was force-placed. The mortgage agreement included a clause requiring the borrower to obtain flood insurance to the extent required by the Department of Housing and Urban Development (HUD). Because HUD's regulations for FHA loans require flood insurance in the amount of the loan balance or the maximum amount available under the NFIP (whichever is less), the borrower claimed both lenders were requiring more insurance than permitted under the mortgage agreement. The court found that the mortgage agreement could reasonably be interpreted to require coverage only in the amount of the current loan balance and denied the motion to dismiss the lawsuit. The other plaintiff, Skinner, had obtained a \$142,000 mortgage and was told at origination that flood insurance was not required. The loan was later sold to Fannie Mae and serviced by CitiMortgage. The mortgage agreement required the borrower to maintain flood insurance in the amount specified by the lender. CitiMortgage notified Casey that the property was in a special flood hazard area and required \$250,000 in flood insurance, which was force-placed when Skinner failed to purchase it. Skinner alleged that the force-placed insurance breached the mortgage



agreement because it authorizes the lender (not the servicer) to require flood insurance. The court found that the plaintiff stated a plausible claim based on the language of the contract and denied the motion to dismiss this claim. The plaintiffs also alleged that the improper force-placed flood insurance, the cost of which was added to the loan balance, constituted a new credit transaction requiring additional disclosures under the Truth in Lending Act (TILA). The court, citing decisions from other federal courts, determined that this allegation stated a plausible claim under TILA at the pleading stage and denied the motion to dismiss this claim.

REGULATION V — FAIR CREDIT REPORTING ACT (FCRA)

Fifth Circuit clarifies damages available under the FCRA. *Smith v. Santander Consumer USA, Inc.*, 703 F.3d 316 (5th Cir. 2012). The Fifth Circuit affirmed a jury award of \$20,437 against a lender that negligently investigated the consumer's dispute of information the lender furnished to TransUnion. After the information was reported to TransUnion, the consumer's credit score dropped from 778 to 652, and the limits on his credit cards were reduced by \$37,500, to \$22,000. In reviewing the jury's verdict, the court clarified the type of damages that could be compensable under the FCRA in this circumstance. The court explained that a reduction in a consumer's credit card limits alone is not a compensable damage. "A credit line, by itself, has no monetary impact on a consumer who doesn't borrow money. Thus, whether the credit line is \$100,000 or \$10,000 may impair the amount he could borrow on a credit line, but unless he takes the actual step of using the credit or showing a need for the higher amount, the consumer is unaffected." Instead, a consumer has compensable damages from a lowered credit limit "if the consumer's cost of actual borrowing increases or if he is refused credit altogether." The court affirmed the jury verdict because the borrower submitted evidence at trial showing that after his credit score dropped, he was charged a higher rate to refinance his mortgage, he deferred making certain expenditures until his credit rating was restored, and he suffered mental pain and anguish.

REGULATION X — REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

The Ninth Circuit clarifies a servicer's obligation in responding to a qualified written request (QWR). *Medrano v. Flagstar Bank, FSB*, 704 F.3d 661 (9th Cir. 2012). The Ninth Circuit affirmed the dismissal of a RESPA QWR lawsuit because the plaintiffs sent written requests to the servicer related to loan origination issues, and the QWR requirements apply only to loan servicing issues. After the servicer notified the plaintiffs that their mortgage escrow account had insufficient funds, the plaintiffs responded with three letters challenging the increased escrow, including allegations that the payment schedule in the loan documents did not accurately reflect the loan broker's representations about the payment schedule, and a request that the monthly mortgage payment be reduced to reflect the broker's representations. The servicer did not change the escrow and did not appear to respond to the letters. The plaintiffs' lawsuit alleged violations of RESPA's QWR requirements, which requires loan servicers to provide timely responses to written inquiries from borrowers about the servicing of their loans. See RESPA, 12 U.S.C. §2605(e); Regulation X, 12 C.F.R. §1024.21(e). The court said a valid QWR must reasonably identify the borrower's name and account; state why the borrower believes the account is in error or provide detail about other information sought; and seek information about the servicing of the loan. For the third requirement, the court noted a distinction between the loan servicing and issues related to the borrower's contractual relationship with the lender. The QWR requirements apply only to servicing issues. The court found that the plaintiffs' letters raised loan origination issues, such as representations made by the mortgage broker, and did not raise any servicing issues. Accordingly, the court affirmed the dismissal of the lawsuit.

* Links to the court opinions are available in the online version of *Outlook* at: <http://www.consumercomplianceoutlook.org>.

SERVICEMEMBER FINANCIAL PROTECTION: Q&A

2. If the customer provides copies of orders from the military to begin active duty, but the customer does not request SCRA benefits, can the bank contact the customer and accept a verbal response as a request for benefits?

With respect to the maximum interest rate on debt, section 3937 of the SCRA states, "In order for an obligation or liability of a servicemember to be subject to the interest rate limitation in subsection (a), the servicemember shall provide to the creditor written notice and a copy of the military orders calling the servicemember to military service and any orders further extending military service, not later than 180 days after the date of the servicemember's termination or release from military service." The statute does not prohibit lenders from providing SCRA benefits without a written request.

However, there is no similar requirement that the service member's notice be in writing to receive foreclosure, eviction, and repossession protections dealing with rent, installment contracts, mortgages, liens, assignment, and leases covered in SCRA sections 3951 through 3953. Therefore, it is the lender's responsibility to know the service member's status prior to undertaking a foreclosure, eviction, or repossession.

3. If a service member purchases a motor vehicle on an installment contract while stateside on active duty and subsequently becomes delinquent on the loan while deployed, which sections of the SCRA apply? Does the financial institution have the right to repossess and dispose of the vehicle if the delinquency is not cured?

The protections of the SCRA apply only to obligations or liabilities entered into before the service member enters military service. See, for example, section 3952(a)(2). In the example raised in the question, the installment contract was entered into while the service member was on active duty; therefore, the SCRA would not apply.

Maximum Rate of Interest on Debts Incurred Prior to Military Service

4. If a service member requests a rate reduction on

"my mortgage loan(s)" or "my obligations" or even one specific loan in cases where he or she holds multiple loans with the creditor, are all loans held with the creditor covered?

Section 3937 of the SCRA, which establishes the maximum interest rate, addresses any "obligation or liability" of an eligible service member, or the service member and the service member's spouse jointly, as long as the loan was made before the service member entered active duty. When a service member provides a written request and a copy of the military orders to a lender, the lender should apply the 6 percent rate reduction to *all* loans with the lender made before the service member entered active duty. Loans for commercial purposes are not excluded from SCRA protections.

5. Per the information provided during the webinar, I understand that fees cannot be in excess of 6 percent for service members. Is it correct that if a service member invokes his or her rights, you cannot charge more than 6 percent for any fees (including late fees and fees for nonsufficient funds), but you can charge up to 6 percent?

Under Section 3937 of the SCRA, the maximum rate of interest on debts incurred prior to military service is 6 percent. Additionally, section 3937(a)(2) of the SCRA provides that interest on debt covered by the SCRA that exceeds the 6 percent cap must be forgiven. The SCRA defines the term interest to include "service charges, renewal charges, fees, or any other charges (except bona fide insurance) with respect to an obligation or liability." A creditor may seek relief from a court in order to impose additional fees and charges based on a finding that the service member's ability to meet the obligation at a rate greater than 6 percent was not materially affected by military service. Accordingly, for obligations covered under the SCRA, creditors should include in the interest calculation any fee or charges incurred with respect to the covered debt, including late payment fees and other fees incurred after origination.

6. Does the bank have to recalculate the monthly payments to reduce the loan interest rate to 6 percent,

or is it acceptable to extend the maturity date and provide the borrower with a new payment schedule?

Section 3937 of the SCRA requires both the forgiveness of interest in excess of 6 percent and the prevention of acceleration of principal. Therefore, the creditor should adjust the interest rate and reflect that reduction in the periodic payment. Any extension of the loan's maturity date would not represent forgiving the interest.

7. Is there a specific requirement to implement the interest rate cap if, for example, notification of active duty is delayed or if late charges are assessed in error? Can we make the choice to issue a cash refund and apply it to a future monthly payment or to the principal balance of the loan? Should we offer the service member the option of reimbursement?

As noted in the FAQs above, the SCRA requires that the interest rate be reduced as of the date of active duty, that interest in excess of 6 percent be forgiven, and that the periodic payment be adjusted. If the interest rate reduction is delayed until after the period of active duty begins, the servicemember is entitled to be reimbursed for the excess interest paid during that delayed period. The SCRA does not require a specific method for reimbursing the excess interest, and does not prohibit a creditor from providing it to the servicemember as a cash refund or timely applying it to current or future monthly payments. However, as also noted, the SCRA prohibits accelerating principal. Therefore, applying the reimbursement to the principal balance of the loan is permitted only if the servicemember chooses that method after being offered other options.

8. If you know that a customer has been deployed and you contact the customer to ask him or her to get the required paperwork from the military and the customer fails to do so, do you have to lower the rate and reduce payments?

Section 3937 of the SCRA requires the service member to provide written notice and a copy of the orders calling the service member to active duty in order for a loan to be subject to the interest rate limitations.

9. When a spouse is on active duty and the insurance on the collateral, be it a home or a car, has been canceled, can collateral-placed insurance (CPI) be put on

the loan? With the general public, when CPI is put on vehicles, the payment does go up, so the loan will mature correctly and it is mentioned in the disclosures at loan signing. When a mortgage has insurance added, it increases only the principal balance of the loan. Is this allowed on service member loans?

As noted in question 5, bona fide insurance is excluded from the 6 percent cap because the SCRA does not define it as interest. With respect to this insurance and the practice you describe, other federal or state laws may apply.

10. What if a bank offers a credit card through a third party? The credit card balances do not sit on the bank's books. Does the bank have to reduce the interest rate on those accounts?

The obligation to reduce the interest rate and payments under section 3937 of the SCRA rests with the creditor. If the financial institution is the creditor, it is responsible for ensuring that the third party reduces the interest rate and payment.

11. How does the term materially affected impact a service member's ability to claim an interest rate reduction on a loan? If, for example, a borrower with a loan voluntarily joins the army, but his or her income does not decrease, do the rate reductions under the SCRA apply?

The rate reductions under section 3937 of the SCRA apply unless a court grants the creditor relief. If the court concludes that the service member's ability to pay interest on the obligation at a rate in excess of 6 percent is not materially affected by the military service, it can order the service member to continue to pay the loan at the original contract rate.

Foreclosure Protection

12. Do foreclosure rules apply only to the service member's primary residence, or do they apply to all loans secured by a mortgage on a residence? Does it matter if the loan is for business purposes?

The SCRA's foreclosure protections in section 3937 apply to any obligation on real or personal property owned by a service member that is secured by a mortgage, trust deed, or other security in the nature of a mortgage. The obligation must have been originated

before the service member's military service, and the service member must still be obligated on it. The statute applies to loans for business purposes and loans secured by the service member's residence, even if it is not the service member's primary residence.

Homeownership Counseling Act

13. According to HUD's Mortgage Letter 2006-28, the SCRA notice is to be sent to all homeowners who are delinquent on a residential mortgage. Could you please clarify what meets the definition of a "residential mortgage"? It clearly includes conventional mortgages and mortgages insured by the Department of Housing and Urban Development (HUD). But does it include junior lien mortgages (home equity loans/lines) and business loans that have a guarantor who gives the bank a mortgage on his or her personal residence? In other words, should the bank send the notice to any individual homeowner with a mortgage on a single-family residence regardless of lien status or purpose?

The SCRA notice requirement at issue, imposed by the Homeownership Counseling Act (12 U.S.C. §1701X(c) (5)(A)), applies to loans secured by a mortgage or lien on the principal residence of the person to whom the notice must be given – whether open- or closed-end, first- or second-lien, business purpose or consumer purpose. The notice requirement is generally triggered when a borrower applies for, or defaults on, a home loan, defined as "a loan secured by a mortgage or lien on residential property" secured by the borrower's or the applicant's principal residence.

Permanent Change of Station Orders

14. Is deployment considered a permanent change of station (PCS) order?

PCS orders occur when the military orders service members to relocate to a new duty station or base. Under 10 U.S.C. §991(b), a service member is "deployed or in a deployment on any day on which, pursuant to orders, the member is performing service in a training exercise or operation at a location or under circumstances that make it impossible or infeasible for the member to spend off-duty time in the housing in which the member resides when on garrison duty at the member's permanent duty station or homeport."

Defense Manpower Data Center

15. We sometimes have difficulty determining what constitutes active duty, and the definition in the SCRA and other laws are vague. Until recently, we relied on HUD Letter 2006-28, which referred to a website and fax and phone numbers to verify military service. Can you provide us with solid guidance on how we can determine active duty status?

The Department of Defense hosts the Defense Manpower Data Center (DMDC) to assist lenders in determining if a particular borrower is currently on active military duty. The data center can be accessed at <https://scra.dmdc.osd.mil/> with the appropriate certificate. With the borrower's name and Social Security number, lenders can use the DMDC to confirm the current military duty status of that individual. Because both foreclosure and repossession processes can extend over longer periods of time, banks are encouraged to incorporate into these procedures more than one assessment of the borrower's service member status.

Miscellaneous

16. Could you state again the name of the law that recently amended the SCRA? Do you have the bill number or Public Law number?

On August 6, 2012, the President signed into law the Honoring America's Veterans and Caring for Camp Lejeune Families Act of 2012, Pub. L. 112-154, 126 Stat. 1165 (2012). Section 710 of the act amended section 303 of the SCRA, 50 U.S.C. §3953.

17. What if the service member's spouse has a loan that is not a joint obligation?

Under section 3937 of the SCRA, the maximum rate of interest on debts incurred before military service benefits applies only to loans incurred by a service member alone or by the service member and the service member's spouse jointly. SCRA protections do not extend to individual obligations of the spouses of service members.

18. Our bank's customers include National Guard members who are on active duty for two weeks a year. Are SCRA protections available to these members?

Under section 3911(2) of the SCRA, a national guard member is entitled to SCRA protections when called

into military service, which is defined as “active service authorized by the President or the Secretary of Defense for a period of *more than 30 consecutive days* under 32 U.S.C. 502(f) for purposes of responding to a national emergency declared by the President and supported by Federal funds” (emphasis added). Active duty for two weeks a year would not qualify as “military service” under section 3911(2) because it is less than 30 consecutive days. Therefore, a two-week training period does not qualify a member of the National Guard for SCRA protections.

RESPONSES FROM THE FEDERAL HOUSING FINANCE AGENCY

1. Under the new Fannie Mae/Freddie Mac programs, service members with Fannie Mae or Freddie Mac loans who receive PCS orders will be eligible to sell their homes in a short sale, even if they are current on their mortgage. What does the program provision stating that a house must be a primary residence mean for current borrowers? Obviously, once service members move, a house is no longer their “primary residence” because they don’t live there anymore. Does it mean a renter is not in the home at the time of the application for a short sale?

The primary residence criterion for current borrowers requires that the borrower, including service members with PCS orders, must be living in the home at the time of the short-sale evaluation. If the service member has already moved out of the house, the loan servicer should submit the case to Fannie Mae or Freddie Mac for review of any special circumstances.

2. What are the appraisal criteria for approving or declining a short sale request?

Loan servicers receive property valuations from the government-sponsored enterprise (GSE, that is, Fannie Mae or Freddie Mac). The borrower is not charged for this property valuation. The GSEs use the property valuation to provide the servicer with the estimated market value of the property. Servicers provide listing price guidance to the borrower based on this estimated market value. The value is provided only for guidance and should not be presented by the servicer as a required listing price. The criteria for approving or declining a short sale can take into account both the estimated market value and the projected costs of the transaction.

3. If a service member on active duty applies for a short sale and the lender has to review the title and order an appraisal in order to review the request, can those costs be charged back to the service member?

Expenses incurred for valuations and title reviews for short sales are not charged to the borrower.

4. In cases where Fannie and Freddie loans involve PCS orders and where deficiencies on a short sale are forgiven without requiring the borrowers to execute a promissory note for the deficiencies, what happens if the private mortgage insurer requires a promissory note to approve the short sale? Are private mortgage insurers allowed to ask for that note, despite the GSE rule?

To date, the following mortgage insurance companies have executed agreements with Fannie Mae and Freddie Mac that allow servicers to make decisions about short sales and borrower contributions in accordance with GSE policies without obtaining the approval of the mortgage insurer: CMG Mortgage Insurance Company, Essent Guaranty, Genworth, MGIC, Republic Mortgage Insurance Company, Radian Guaranty, PMI, Triad, and United Guaranty. These companies will not pursue a separate action to recover any deficiency. For mortgage insurance companies not listed, the servicer must obtain their approval on a case-by-case basis, and it is up to the mortgage insurance company to determine whether the situation warrants a contribution (or whether the company will waive it).

5. How does a servicer find out about a service-related death? Is the onus on the surviving spouse to notify the lender? Or is the information in the DMDC (or similar data source)?

The military will notify only the service member’s family or next of kin in case of death. It is the responsibility of the service member’s family or designated representative to handle personal affairs for the deceased; the servicer may also obtain this information from the surviving spouse when attempting to make right party contact to ascertain the reason for delinquency.

6. Does the Home Affordable Modification Program (HAMP) apply to both Fannie/Freddie mortgages and

private mortgages? Where is the best place to find more information on this program?

HAMP is a federal program that applies to many participating institutions throughout the mortgage lending industry. Both Freddie Mac and Fannie Mae have implemented requirements for HAMP that are specific to their mortgages. These requirements are not exactly the same as HAMP requirements published by the U.S. Department of the Treasury but are substantially similar. To learn more about HAMP, visit www.hmpadmin.com and select the HAMP link from the drop-down menu under the Programs tab. That link provides information on HAMP and related requirements for servicers of non-GSE mortgages. To learn more about Freddie Mac's implementation of HAMP, see: http://www.freddiemac.com/singlefamily/service/mha_modification.html and to learn more about Fannie Mae's implementation of HAMP, see: <http://www.knowyouroptions.com/modify/home-affordable-modification-program>.

7. If our bank provides a new refinance loan under the Home Affordable Refinance Program (HARP), the loan origination date is now after the start of military service and the service member no longer qualifies for the 6 percent reduction. Is there an exception to this?

To date, an exception to the policy has not been necessary because borrowers who refinance under HARP obtain a rate well below the 6 percent rate provided for under the SCRA provisions. Only if the market interest rate increases above the 6 percent threshold would it be necessary to consider a waiver allowing the origination date of the loan to be after the military start date.

RESPONSES FROM THE TREASURY

1. What if our loans are portfolio only and not sold to Fannie/Freddie or any other government-sponsored enterprise. Can we offer HAMP or Home Affordable Foreclosure Alternatives (HAFA)?

Many servicers that are not enrolled in Making Home Affordable (MHA) for their non-GSE loans have created modification and short-sale programs very similar to HAMP and HAFA. These servicers are not eligible to receive Treasury-funded incentives but can offer mod-

ifications that follow the HAMP waterfall to reduce a borrower's payment to 31 percent of the borrower's debt-to-income ratio and provide the borrower with the same types of protections that HAMP borrowers have. For short sales, servicers that are not able to offer HAFA can still pre-approve a borrower to sell his or her home and can agree in advance to accept certain net proceeds, agree to waive all deficiencies, and pay borrowers a relocation incentive.

2. How are we supposed to know if customers are members of the military if they don't tell us?

In the MHA program, this information is required on the Request for Mortgage Assistance form. Servicers that don't participate in the MHA should consider requesting this information on in-house application forms.

3. In a short-sale situation, if a bank is the second-lien holder and the first-lien holder is trying to make a HAFA loan, is the second-lien holder obligated to complete the short sale under HAFA guidelines?

No, second-lien holders are not obligated to accept the maximum second-lien release payment of \$8,500 and waive all deficiencies. However, all of the largest lenders generally do cooperate, since they also have first liens that they would like to short sell under HAFA and they need the cooperation of their peers. Some smaller second-lien holders also accept the HAFA terms because the alternative is often foreclosure.

4. Is there any guidance so that HAFA/short sales will not negatively affect the credit reports of military members?

Unfortunately, the Treasury cannot control the way credit is reported or used by the consumer agencies. Any short sale will have some negative impact because it indicates that the borrower could not repay the entire debt. However, the impact is much less if the borrower is current at the time of the short sale, so the Treasury has encouraged borrowers to stay current on the loan until the HAFA transaction closes.

Specific issues and questions should be raised with your primary regulator. ©

2012 YEAR IN REVIEW WEBINAR: Q&A

1005.36). This situation can be problematic for remittance transfers conducted through open-network systems, where remittance transfer providers do not control the remittance transfer from start to finish but instead rely on intermediaries to complete a transfer. The parties to an open-network remittance transfer typically rely on Article 4-A to provide the legal framework for their rights and responsibilities. Most remittance transfers are conducted through the Federal Reserve System's Fedwire® Funds Service (Fedwire) or through CHIPS, an electronic payment, clearing, and settlement service operated by the Clearing House.

To address this issue, the Federal Reserve Board amended its Regulation J (Fedwire) in April 2012. See 77 Fed. Reg. 21,854 (April 12, 2012). The amendment, which became effective July 12, 2012, clarifies that Article 4-A applies to Fedwire remittance transfers subject to EFTA section 919, unless there is a conflict with the EFTA, in which case the EFTA governs. See 12 C.F.R. §210.25.

Similarly, in March 2012, the Clearing House amended the choice of law provision in its Rules and Administrative Procedures to clarify that Article 4-A of the New York UCC applies to remittance transfers subject to section 919 of the EFTA that are made through CHIPS, except in the case of an inconsistency between New York law and the EFTA, in which case the EFTA governs. The New York legislature also amended New York UCC section 4-A-108 in August 2012 to provide that Article 4-A applies to remittance transfers subject to the EFTA, unless there is a conflict with the EFTA, in which case the EFTA governs. For additional information, view the presentation slides on this issue from a September 6, 2012, symposium at the Federal Reserve Bank of Atlanta ("A Symposium on 1073: Exploring the Final Remittance Transfer Rule and the Path Forward").⁴

BIGGERT-WATERS FLOOD INSURANCE REFORM ACT OF 2012 (BIGGERT-WATERS ACT)

7. Where in the Biggert-Waters Act does it refer to the force-placement 45-day period based on which the lender can be reimbursed for the premium?

Section 100244(a)(1) of the Biggert-Waters Act amends the Flood Disaster Protection Act of 1973 to allow lenders to be reimbursed for the cost of purchasing flood insurance and incidental fees beginning on the day a policy lapsed or had insufficient coverage: "If the borrower fails to purchase such flood insurance within 45 days after notification under paragraph (1), the lender or servicer for the loan shall purchase the insurance on behalf of the borrower and may charge the borrower for the cost of premiums and fees incurred by the lender or servicer for the loan in purchasing the insurance, *including premiums or fees incurred for coverage beginning on the date on which flood insurance coverage lapsed or did not provide a sufficient coverage amount*" (emphasis added).

8. Was there a technical error in the flood act that required escrows for loans secured by nonresidential buildings?

As originally drafted, section 100209 of the Biggert-Waters Act contained escrow requirements that apply to "improved real estate." This language raised a concern in the industry that loans secured by commercial real estate would also be subjected to escrow requirements. In response, Congress passed S.3677, which makes a technical correction to the escrow requirements to clarify that they apply only to residential improved real estate. On January 14, 2013, the President signed the bill into law, which became effective that day.

9. What is the effect of the Biggert-Waters Act on grandfathered properties?

Grandfathering is the practice of allowing certain building owners to lock in the current flood zone ratings and premiums for their properties before rates are increased because of a flood map change with a higher flood zone rating. Grandfathering is available for property owners who either have a flood insurance policy in effect when a new flood insurance rate map (FIRM) becomes effective and then maintain continuous coverage, or if the building complied with the FIRM requirements in effect at the time of construction. However, grandfathering does not apply if a

⁴ <http://tinyurl.com/ucc-efta>

building has been substantially damaged or improved. For additional information on grandfathering, refer to FEMA's publication "NFIP Grandfather Rules."⁵

Section 100207 of the Biggert-Waters Act phases out grandfathering. This provision provides that upon the effective date of any revised or updated FIRM, any property located in a community participating in the National Flood Insurance Program shall have the risk premium rate charged for flood insurance on such property adjusted to accurately reflect the current risk

of flood to such property. The premium increase will be phased in over a five-year period.

To reflect the current risk of flooding, FEMA periodically updates the nation's FIRMs. In addition, section 100216 of the Biggert-Waters Act requires FEMA to establish an ongoing program to review and update FIRMs and to follow the requirements in section 100216 in doing so. If FEMA assigns a higher flood risk rating to an area after an update, the flood insurance premiums in that community will increase.

⁵ <http://tinyurl.com/grandfather-rule>

Specific issues and questions should be raised with your primary regulator. ©

CONTINUED FROM PAGE 5...

CREDIT CARD ACT REQUIREMENTS FOR GIFT CERTIFICATES, STORE GIFT CARDS, AND GENERAL-USE PREPAID CARDS

Loyalty, Award, and Promotional Gift Cards

Loyalty, award, and promotional gift cards are typically not funded by the consumer but by the entity sponsoring the card program. To qualify for the exclusion, the card must meet three requirements. It must 1) be issued on a prepaid basis primarily for personal, family, or household purposes to a consumer in connection with a loyalty, award, or promotional program; 2) be redeemable at one or more merchants for goods or services, or it can be used at an automated teller machine; and 3) make certain disclosures. To facilitate compliance, comment 20(a)(4)-1 provides seven illustrative (but not exhaustive) examples.

While loyalty, award, or promotional gift cards are not subject to the Credit CARD Act's substantive restrictions on fees and expiration dates, certain disclosure requirements still apply. In particular, the front of the card must disclose the expiration date and state that it is issued for loyalty, award, or promotional purposes.

Printing "Reward" or "Promotional" on the front of the card satisfies this requirement.¹⁷ Issuers must also disclose a toll-free number anywhere on the card and (if applicable) a website address that a consumer can use to obtain fee information. Finally, any fees and the conditions under which they may be imposed must be disclosed on or with the card, code, or device.¹⁸

Cards Not Marketed to the General Public

In determining whether cards are marketed to the general public, the regulation focuses on the means or channel through which the card, code, or device is obtained by the consumer, the subset of consumers eligible to obtain the card, and whether the availability of the card is advertised or promoted in the marketplace.¹⁹ Comment 20(b)(4)-2 provides some examples illustrating the exclusion, including a card containing insurance proceeds provided by an insurance company to a customer to settle a claim; a card containing store credit provided by a retailer to a customer following a merchandise return if the card states that it is issued for store credit; and a card containing tax refunds provided by a tax preparer to a customer. Examples that do not meet the definition include the following: a merchant selling its gift cards

¹⁷ Comment 20(a)(4)(2)

¹⁸ 12 C.F.R. § 1005.20(a)(4)(iii)(C)

¹⁹ Comment 20(b)(4)-1

at a discount to a business that may give them to employees or consumers as incentives or rewards, if the card can also be purchased through retail channels; a bank marketing gift cards only to its customers, if a member of the general public can become one of the bank's customers; and a card issuer advertising a reloadable card to teenagers and their parents, promoting the card for use by teenagers and by parents to monitor spending, if the card is marketed and sold to any member of the general public.²⁰

vice fee²⁴ on a gift certificate, store gift card, or general-use prepaid card unless three conditions are met:

WHILE LOYALTY, AWARD, OR PROMOTIONAL GIFT CARDS ARE NOT SUBJECT TO THE CREDIT CARD ACT'S SUBSTANTIVE RESTRICTIONS ON FEES AND EXPIRATION DATES, CERTAIN DISCLOSURE REQUIREMENTS STILL APPLY.

Cards Issued in Paper Form Only

This exclusion applies when the only means of issuing the card, code, or other device is in paper form.²¹ For example, the exclusion would not apply if a bar code or certificate number is provided to the consumer in electronic format and can be reproduced in paper form because the information necessary to redeem the value was initially issued to the consumer in electronic form.²²

Cards Redeemable Solely for Admission to Events or Venues

This exclusion is limited to cards, codes, or other devices that do not state a specific monetary value but instead are redeemable for admission to an event or venue. Furthermore, the exclusion covers any goods or services that may be obtained at specific locations affiliated with and in geographic proximity to the event or venue.

GENERAL REQUIREMENTS

Dormancy, Inactivity, or Service Fees

No person²³ may impose a dormancy, inactivity, or ser-

- There has been no activity within the one-year period prior to imposing the fee;
- Only one fee may be assessed in a calendar month; and
- Disclosures are clearly and conspicuously stated on the certificate or card regarding dormancy, inactivity, or service fees. Furthermore, the disclosures must be provided before purchase.²⁵

The Commentary clarifies these requirements.

One-Year Period with No Activity.

Comment 20(d)-1 provides three examples of this requirement:

- i. A certificate or card is purchased on January 15 of year one. If there has been no activity on the certificate or card since the certificate or card was purchased, a dormancy, inactivity, or service fee may be imposed on the certificate or card on January 15 of year two.

²⁰ Comment 20(b)(4)-2.i.-vi

²¹ Comment 20(b)(5)-1

²² Comment 20(b)(5)-1

²³ Person is broadly defined in 12 C.F.R. §1005.2(j) as a natural person or an organization, including a corporation, government agency, estate, trust, partnership, proprietorship, cooperative, or association.

²⁴ Service fee is defined as a recurring maintenance fee or activity fee such as balance inquiry, ATM, or reload fee. The definition does not include a one-time fee or fee unlikely to be imposed more than once while the underlying funds are still valid, such as an initial issuance fee, a cash-out fee, a supplemental card fee, or a lost or stolen certificate or card replacement fee. Comment 20(a)(6)-1.

²⁵ 12 C.F.R. §1005.20(c)(3) and (d)

- ii. Same facts as i., and a fee was imposed on January 15 of year two. Because no more than one dormancy, inactivity, or service fee may be imposed in any given calendar month, the earliest date that another dormancy, inactivity, or service fee may be imposed, assuming there continues to be no activity on the certificate or card, is February 1 of year two. A dormancy, inactivity, or service fee is permitted to be imposed on February 1 of year two because there has been no activity on the cer-

TO ENSURE THAT CONSUMERS ARE AWARE OF DORMANCY, INACTIVITY, AND SERVICE FEES BEFORE PURCHASING A GIFT CARD OR CERTIFICATE, DISCLOSURES MUST BE MADE NOT ONLY ON THE CARD OR CERTIFICATE ITSELF BUT ALSO PRIOR TO PURCHASE.

tificate or card for the preceding year (February 1 of year one through January 31 of year two), and February is a new calendar month. The imposition of a fee on January 15 of year two is not activity for purposes of 12 C.F.R. §1005.20(d). See comment 20(a)(7)-1.

- iii. Same facts as i., and a fee was imposed on January 15 of year two. On January 31 of year two, the consumer uses the card to make a purchase. Another dormancy, inactivity, or service fee could not be imposed until January 31 of year three, assuming there has been no activity on the certificate or card since January 31 of year two.

Restriction on Imposing More Than One Fee Per Month. Comment 20(d)-4 includes an example of this requirement. If after a year of inactivity, a dormancy fee is imposed on January 1, 2014, a balance inquiry fee could not also be imposed in January 2014 because a dormancy fee was imposed in the same calendar month.²⁶ To prevent circumvention of this requirement, Comment 20(d)-5 prohibits the accumulation of fees. This refers to the practice of accumulating dor-

mancy, inactivity, or service fees for previous periods into a single fee that would circumvent the restriction on charging more than one fee per month. Comment 20(d)-5 provides this example: “If a consumer purchases and activates a store gift card on January 1 but never uses the card, a monthly maintenance fee of \$2.00 a month may not be accumulated such that a fee of \$24 is imposed on January 1 the following year.”

Requirements for Disclosures on Card/Certificate and Before Purchase. To ensure that consumers are aware of dormancy, inactivity, and service fees before purchasing a gift card or certificate, disclosures must be made available pre-purchase and appear on the card or certificate itself. In some circumstances, a single disclosure will satisfy both requirements, but in other cases, two sets of disclosures are required: those on the card/certificate and those made available pre-purchase. For example, if the disclosures on a certificate or card required by 12 C.F.R. §1005.20(d)(2) are

obstructed by the packaging, the disclosures would also have to appear on the packaging sold with the card or certificate. But if the disclosures were visible to the consumer without removing the packaging, additional disclosures would not be required.²⁷

EXPIRATION DATES

The expiration date of the underlying funds of a gift certificate, store gift card, or general-use prepaid card must be no less than five years after the date of issuance (in the case of a gift certificate) or five years after the date of last load of funds (in the case of a store gift card or general-use prepaid card).²⁸ No person may sell or issue such a certificate or card with an expiration date unless the person has established policies and procedures that provide the consumer with a reasonable opportunity to purchase a product that has an expiration date at least five years from the date of purchase.

²⁶ Comment 20(d)-4

²⁷ Comment 20(d)-2

²⁸ 12 C.F.R. §1005.20(e)(2)

Note, however, that this requirement ceases to apply once the certificate or card has been fully redeemed.²⁹

The expiration date for the underlying funds, or a statement that the underlying funds do not expire, must be disclosed on the certificate or card.³⁰ Additionally, as applicable, the issuer must disclose on the card or certificate a toll-free number and a website, if one is maintained, that a consumer may use to obtain a replacement card or certificate after expiration if the card or certificate expires before the underlying funds expire.³¹

To prevent consumer confusion, a disclosure is also required when the certificate or card expiration date differs from the expiration date of the underlying funds. This disclosure must be stated with equal prominence and in close proximity to the certificate's or card's expiration date. This disclosure requirement does not apply to nonreloadable certificates or cards that have an expiration date of at least seven years from the date of manufacture.³² All of these expiration date disclosures are required to be made prior to purchase.³³

The regulation also prohibits imposing fees to replace an expired certificate or card if the underlying funds remain valid to ensure that consumers have full use of the underlying funds for the minimum five-year period.³⁴

ADDITIONAL FEE DISCLOSURES

Information related to additional fees that are not considered dormancy, inactivity, or service fees, such as

initial issuance and cash-out fees, is also required to be disclosed, as applicable. The type of fee, the amount of the fee (or an explanation of how the fee will be determined), and the conditions under which the fee may be imposed are required to be disclosed. Whereas dormancy fees and expiration dates must be disclosed on the card or certificate, the information related to these additional fees can be stated on or with the card or certificate and must be provided prior to purchase.³⁵ The final rule also requires disclosure of a toll-free number on the card or certificate and a website, if one is maintained, that a consumer may use to obtain fee information.³⁶

FORM OF THE DISCLOSURES

Generally, the disclosures must be provided in written or electronic format and in a manner that is "clear and conspicuous." As explained in the Commentary, this means disclosures that are readily understandable and in a location and size that are readily noticeable to consumers.³⁷ While the final rule does not require a particular type size, the print must contrast with and otherwise not be obstructed by the background on which it is printed.³⁸ The disclosures must be made on the certificate, card, code, or other device.³⁹ A disclosure made in an accompanying terms and conditions document, on packaging surrounding a certificate or card, or on a sticker or other label affixed to a certificate or card does not constitute a disclosure on the certificate or card.⁴⁰ In some cases, gift certificates or cards are issued in the form of a code provided by telephone. In this instance, the disclosures may be provided orally prior to purchase. After the disclosures are provided orally, the issuer must promptly provide to the consumer a written or electronic copy of the code or confirmation and the required disclosures must be contained on the copy.

CONCLUSION

The Regulation E gift card amendments impose disclosure requirements and substantive restrictions on store gift cards, gift certificates, and general-use prepaid cards concerning fees and expiration dates. Persons offering these products must ensure compliance with the required disclosures and restrictions. To satisfy the disclosure requirements, institutions should consider whether they meet the clear and conspicuous standard and whether the disclosures are the correct size and in the correct location. Specific issues and questions should be raised with your primary regulator. ©

²⁹ Comment 20(e)-13

³⁰ 12 C.F.R. § 1005.20(e)(3)(i)

³¹ 12 C.F.R. § 1005.20(e)(3)(ii)

³² 12 C.F.R. § 1005.20(e)(3)(iii)

³³ 12 C.F.R. § 1005.20(c)(3)

³⁴ 12 C.F.R. § 1005.20(e)(4)

³⁵ 12 C.F.R. § 1005.20(f)(1)

³⁶ 12 C.F.R. § 1005.20(f)(2)

³⁷ Comment 20(c)(1)-1

³⁸ Comment 20(c)-1

³⁹ 12 C.F.R. § 1005.20(a)(4)(iii), (d)(2), (e)(3), and (f)(2)

⁴⁰ 12 C.F.R. § 1005.20(c)(4)

CALENDAR OF EVENTS

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| April 2013 | Regulatory Update Seminar Series
Federal Reserve Bank of Kansas City
This seminar will be offered in 10 different locations.
Visit the website for details at www.kc.frb.org/events/index.cfm?cat=Banking |
| April 11-12, 2013 | Resilience & Rebuilding for Low-Income Communities:
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Federal Reserve System
Renaissance Hotel
Washington, D.C. |
| May 8-10, 2013 | 49th Annual Conference on Bank Structure and Competition
Federal Reserve Bank of Chicago
J. W. Marriott Hotel
Chicago, IL |
| June 9-12, 2013 | Regulatory Compliance Conference
American Bankers Association
Hyatt Regency
Chicago, IL |