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A FEDERAL RESERVE SYSTEM PUBLICATION FOCUSING ON CONSUMER COMPLIANCE TOPICS

Inside

The Federal Reserve System's Top-Issued Fair Lending Matters Requiring Immediate Attention and Matters Requiring Attention

By Scott Sonbuchner, Senior Examiner, Federal Reserve Bank of Minneapolis

Since 2023, *Consumer Compliance Outlook* (*CCO*) has been publishing data-driven articles on top violations and complaints for institutions the Federal Reserve supervises. In this issue, we are publishing an article on a third supervisory data point: top-issued Matters Requiring Immediate Attention (MRIAs) or Matters Requiring Attention (MRAs), which we refer to as *matters*. This article discusses the top-issued fair lending matters. We believe data-driven articles can help institutions assess compliance risk in their operations by identifying areas where other institutions faced challenges, how they remediated those challenges, and ways to mitigate risks.

MRIAs AND MRAs

The Federal Reserve System is the primary federal regulator for state member banks (SMBs). Communicating supervisory findings to management and the board of directors of a regulated institution is an important aspect of supervision. The report of examination is the primary way bank supervisors communicate findings. But when examiners find systemic weaknesses in an institution's compliance management system or systemic violations of consumer laws that raise significant supervisory concerns, they can issue an MRIA or MRA or take other formal or informal enforcement actions to ensure the board and management are aware of the concerns and promptly undertake corrective actions.

MRIAs

As discussed in Federal Reserve Supervision and Regulation (SR) letter 13-13/Consumer Affairs (CA) letter 13-10, "Supervisory Considerations for the Communication of Supervisory Findings,"[1] MRIAs can arise from an examination, an inspection, or any other supervisory activity that raises major concerns, including:

- significant noncompliance with applicable laws or regulations;
- practices that can cause significant consumer harm;
- repeat criticisms on which the institution is not taking action or to which it is paying insufficient attention; and

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Top Federal Reserve System Compliance Violations in 2023 Under the Equal Credit Opportunity Act

By Consumer Compliance Outlook Staff

The Equal Credit Opportunity Act (ECOA), as implemented by Regulation B, requires creditors to notify consumers and businesses applying for credit about the action taken on their applications within specified time periods. If adverse action[1] is taken, the creditor must provide an adverse action notice (AAN) disclosing the reasons for taking adverse action, the key factors affecting an applicant's credit score if it was used in the credit decision, and the contact information for the lender's primary federal regulator.[2] An AAN provides transparency to applicants about the credit underwriting process and helps protect them against potential credit discrimination by requiring creditors to specify the reasons for taking adverse action and the contact information for the creditor's federal regulator if the applicant believes discrimination occurred and wants to file a complaint.

Violations of the AAN requirements were among the Federal Reserve's top-cited compliance violations in 2023. This article reviews the violations and sound practices to mitigate risks. The format for common violations articles is to list the regulatory requirements (either by quoting the text or by summarizing it) and then discuss the specific violations, root causes, and sound practices.

REGULATORY REQUIREMENTS

Adverse action definition: 12 C.F.R. §1002.2(c)(1)

(i) A refusal to grant credit in substantially the amount or on substantially the terms requested in an application unless the creditor makes a counteroffer (to grant credit in a different amount or on other terms) and the applicant uses or expressly accepts the credit offered;
(ii) A termination of an account or an unfavorable change in the terms of an account that does not affect all or substantially all of a class of the creditor's accounts; or
(iii) A refusal to increase the amount of credit available to an applicant who has made an application for an increase.

Time periods for notifying an applicant of the action taken: 12 C.F.R. §1002.9(a)(1)

- 30 days after receiving a completed application;
- 30 days after taking an adverse action on an incomplete application, unless notice is provided under §1002.9(c);
- 30 days after taking adverse action on an existing account; or
- 90 days after notifying the applicant of a counteroffer if the applicant does not expressly accept or use the credit offered.

A common violation was failing to provide an AAN within 30 days after receiving a completed application on which adverse action was taken.

ROOT CAUSES

For consumer credit, a creditor has 30 days after receiving a completed application to notify the applicant in writing of the credit decision. In some cases, violations occurred because staff members did not understand the regulatory requirements of sending a *written* AAN. Staff believed oral notification complied, where they had notified applicants by telephone and did not send a written AAN. In other cases, staff did not understand the timing requirements. This reflected inadequate training on AAN requirements.

Examiners also noted weaknesses in the monitoring and audit functions, including internal testing or quality control, that should have provided a second line of defense to recognize that loan staff failed to send timely, written AANs.

SOUND PRACTICES TO MITIGATE COMPLIANCE RISKS

Most of the violations discussed occurred because of inadequate oversight by management and a lack of appropriate employee training. The table lists compliance practices that examiners have observed and recommend.

CONCLUDING REMARKS

This article discusses common ECOA violations and sound practices to mitigate risks related to AANs. Specific issues and questions should be raised with your primary regulator. ■

TABLE: Sound Compliance Practices

Board and Senior Management Oversight	• Review management information systems, including audit reports, to stay apprised of systemic issues and respond appropriately
Internal Controls	• Create a ticker for each loan application to remind staff of the deadline to notify the applicant of the action taken on a completed loan application • Review controls to ensure they are working to flag the deadline for sending an AAN
Consumer Complaints	• Review complaints received by the institution or by the Federal Reserve Consumer Help complaint system for possible internal control weaknesses for the issues noted in this article, adjusting and strengthening processes as needed to ensure compliance
Training	• Conduct regular training on the notice requirements under §1002.9 of Regulation B • Identify and train for pain points, such as the effect of incomplete applications or counteroffers on AAN requirements • Include training when regulatory changes or procedural weaknesses are noted • Provide flowcharts and worksheets for staff
Monitoring and Audit	• Conduct frequent audits of loans • Validate that all policies and procedures are applied correctly
Policies and Procedures	• Implement detailed policies and procedures to ensure a consistent and repeatable process

Endnotes

[1] *Adverse action* is defined in ECOA, 15 U.S.C. §1691(d)(6), and in Regulation B, 12 C.F.R. §1002.2(c).

[2] 12 C.F.R. §1002.9(a)(2) and (b)(2).

Top-Cited Federal Reserve System Compliance Violations in 2023 Under the Truth in Lending Act for the TILA RESPA Integrated Disclosure

By Consumer Compliance Outlook Staff

Before the Dodd–Frank Act was enacted in 2010, consumers applying for most closed-end, residential mortgage loans received disclosures under both the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA), of loan and settlement costs, respectively. But the disclosures overlapped to a degree and risked overloading the consumer with pages of complex information. To address this issue, the Dodd–Frank Act directed the Consumer Financial Protection Bureau (CFPB) to combine the required TILA and RESPA disclosures into a single disclosure, commonly known as the TILA RESPA integrated disclosure (TRID),[1] and to conduct consumer testing of the disclosure to improve comprehension.[2] The CFPB's final rule implementing the TRID, which became effective in October 2015, requires creditors to provide a Loan Estimate within three business days after receiving an application[3] and a Closing Disclosure at least three business days prior to consummation.[4]

A review of data from Federal Reserve compliance examinations showed that violations of the Closing Disclosure requirements as set out in Regulation Z, TILA's implementing regulation, were among the top-cited violations in 2023. Those violations of Regulation Z involved understating the finance charge for discounted, adjustable rate mortgages (ARMs) and incorrectly listing the names of the settlement service providers.

The format for *Consumer Compliance Outlook* common violation articles is to first summarize the regulatory requirements and then discuss the violations, root causes, and sound practices that can help prevent violations.

REGULATORY REQUIREMENTS

Disclosure of finance charge: 12 C.F.R. §1026.38(o)(2)
Requires disclosure of the "Finance Charge," using that term and expressed as a dollar amount, and the following statement: "The dollar amount the loan will cost you." The disclosed finance charge and other disclosures affected by it, including the amount financed and the annual percentage rate (APR), will be treated as accurate if the finance charge: (i) is understated by no more than $100; or (ii) is greater than the amount required to be disclosed.

UNDERSTATED FINANCE CHARGE FOR ARM LOANS

Examiners observed the disclosure of understated finance charges for discounted ARM loans in excess of the finance charge $100 tolerance. A discounted ARM loan provides the borrower with a lower interest rate for a period of time, after which a variable rate applies, typically based on an index and a margin. For these loans, the disclosures must reflect a composite APR based on the initial rate for as long as it is charged and, for the remainder of the term, the rate that would have been applied using the index or formula at the time of consummation.[5] Errors occurred because the fully indexed interest rate was not included in the finance charge determinations. The understated finance charge also affected the accuracy of the APR of some of the loans because the APR is calculated using the finance charge.[6]

The root causes included an issue with the software used to prepare the disclosures, modest weaknesses in training because staff was unaware of the proper calculation steps, and weaknesses in internal controls that failed to flag miscalculations in the loan software.

REGULATORY REQUIREMENTS

Disclosure of settlement services: 12 C.F.R. §1026.38(f)(2)
Requires disclosure of settlement services that a borrower did not shop for and provided by persons other than the creditor or a mortgage broker. These services must be itemized with their corresponding costs and the name of the person receiving final payment. A total of all itemized amounts designated borrower-paid at or before closing must also be disclosed. Examples of services that cannot be shopped for are: appraisal fee, appraisal management company fee, credit report fee, flood determination fee, government funding fee, homeowners association certification fee, lender's attorney fee, and tax status research fee.

LISTING INCORRECT INFORMATION

Examiners also observed disclosures that inputted incorrect information into the field for third-party services the borrower cannot shop for. The root cause was loan processors making mistakes while manually inputting the data, reflecting inadequate training for inputting information and inadequate controls to detect the errors before providing the disclosures to the borrower.

The table lists compliance practices that examiners have observed and recommend to mitigate compliance risks.

CONCLUSION

This article discusses common violations and sound practices to mitigate risks related to the Closing Disclosure. This disclosure provides critical loan information to applicants to help them make informed decisions, so it is important that accurate information be provided. Violations noted here involving understated finance charges and APRs are particularly significant because the harm is material and may involve restitution. Specific issues and questions about TILA and Regulation Z requirements should be raised with your primary regulator. ■

TABLE: Sound Compliance Practices

Training	• Conduct regular TILA training to ensure that employees accurately input data into Closing Disclosures • Identify and train for difficult or confusing situations • Provide flowcharts and example forms for staff
Consumer Complaints	• Review complaints received by the institution or by the Federal Reserve Consumer Help complaint system for possible internal control weaknesses, adjusting and strengthening processes as needed to ensure compliance
Controls	• Conduct secondary review of disclosures • Validate TILA disclosure software before implementing it
Monitoring	• Keep open communication with loan software provider to protect against errors and ensure patches and updates are received and implemented • Ensure that third parties are aware of their compliance requirements
Policies and Procedures	• Implement detailed policies and procedures

ENDNOTES*

1 12 U.S.C. §5532(f).

2 12 U.S.C. §5532(b)(3).

3 12 C.F.R. §1026.19(e)(1).

4 12 C.F.R. §1026.19(f)(1).

5 Comment 17(c)(1)-10(i).

6 The APR is subject to a tolerance of one-eighth of 1 percentage point for loans whose monthly payments are generally uniform ("regular transaction"), while loans with nonuniform payments such as ARM loans ("irregular transaction") are subject to a tolerance of one-quarter of 1 percentage point. 12 C.F.R. §1026.22(a)(2) and (3), respectively; Interagency Examination Procedures for the Truth in Lending Act at p. 41. Whether an understated finance charge affects the accuracy of the APR depends on the degree to which the finance charge is understated in excess of the $100 tolerance. A larger understatement is more likely to affect the APR's accuracy. But note: If the finance charge for a mortgage loan is understated *within* the $100 tolerance, all other disclosures calculated using the finance charge, such as the APR and amount financed, are deemed accurate. 12 C.F.R. §1026.18(d)(1).

* Note: The links for the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at consumercomplianceoutlook.org.

Complex Bank–Fintech Partnerships

By Clay Kitchura, Senior Financial Institution Policy Analyst, Division of Supervision and Regulation, Federal Reserve Board

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The community banking sector has seen a great deal of technological change and innovation in recent years. However, while community banks continue to explore and adopt emerging technologies, their mission remains the same: to provide high-quality financial services to the communities they serve.

In recent years, community banks have explored innovative approaches to achieve that mission, often turning to nonbank companies, including financial technology companies, or fintechs, to access new technologies and skill sets. In some cases, they have formed complex partnerships with fintechs;[1] in such partnerships, a fintech provides end customers with access to a bank's products and services. While the details of these partnerships vary, they commonly facilitate deposit-taking, payments services, and lending activities. This article provides an overview of the Federal Reserve's supervisory approach to complex bank–fintech partnerships and discusses common risk factors associated with them.

SUPPORT FOR RESPONSIBLE INNOVATION

Complex bank–fintech partnerships can enable community banks to leverage newer technology and better compete with larger banks in offering innovative products and services. They may also help banks meet changing consumer demands and expectations and reduce the prices consumers pay for banking services. The Federal Reserve recognizes the importance of these benefits for community banks and the communities they serve. However, it is also important to understand that new practices often involve risk. Harnessing the benefits while ensuring that the risks are appropriately managed is foundational to responsible innovation in the banking sector. Supervision and regulation must balance the risks from overregulation, which can stifle innovation, with those from underregulation, which can lead to harm to households, financial institutions, and the financial system. As part of the Federal Reserve's support for responsible innovation, it aims to use its perspective as a regulator to engage with and provide helpful resources for the banking sector.

THE FEDERAL RESERVE'S NOVEL ACTIVITIES SUPERVISION PROGRAM

In August 2023, the Federal Reserve established the Novel Activities Supervision Program,[2] with dedicated staff to help strengthen oversight of novel activities at supervised institutions. By bringing together staff focused on novel activities, the Federal Reserve continues to build upon and expand its knowledge of novel activities, to identify associated risks as early as possible, and to assess the ability of banks to appropriately manage those risks.

Complex bank–fintech partnerships are one focus of the Novel Activities Supervision Program. While these partnerships can provide benefits, supervisory experience has identified a range of safety and soundness, compliance, and consumer protection–related concerns with the management of these partnerships. Supervisors are working with banks to assess the benefits and risks of such partnerships as well as the effectiveness of banks' controls to manage these risks. Information gathered from examination, analysis, and monitoring activities, and from stakeholder engagement, helps to inform policymakers as they work to enhance the Federal Reserve's regulatory and supervisory frameworks to support responsible innovation.

RECENT POLICY DEVELOPMENTS

In July 2024, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (collectively, "the agencies") published two documents to share their understanding of the issues associated with complex bank–fintech partnerships with the public and to continue building on that understanding by inviting public comment.

- **Supervision and Regulation (SR) letter 24-5**, **"Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Services,"** is an interagency statement that identifies risks present in arrangements with third parties to deliver bank deposit products and services, offers examples of practices to manage those risks, and reminds banks of existing requirements and supervisory expectations. The statement includes an extensive list of resources, including rules and guidance, that are relevant to these arrangements.

- **The Request for Information (RFI) on Bank–Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses** solicited information from the public on complex bank–fintech partnerships that involve deposit, payments, and lending products and services. The RFI shared the agencies' understanding of these arrangements, including their benefits and risks. Moreover, the RFI provided the agencies with an opportunity to hear from the public on various aspects of these arrangements.

RISK FACTORS ASSOCIATED WITH COMPLEX BANK–FINTECH PARTNERSHIPS

As the agencies explain in the RFI, complex bank–fintech partnerships can pose risks to banks and consumers in new ways, from new places, or with more severity. These novel manifestations of risk can be challenging for some compliance and risk management frameworks that are calibrated to more traditional risk patterns.

While risk is inherent in the business of banking, supervisors expect banks to be adequately prepared to identify, measure, and manage the risks they face. Community bankers engaging in complex bank–fintech partnerships will want to consider how their governance and risk management frameworks are fit for new risk patterns. The following are some commonly observed risk management challenges:[3]

- **Accountability**: Banks and fintechs may divide contractual accountability for aspects of the customer relationship between them. However, the bank remains responsible for compliance with all applicable laws, and this contractual division of labor can complicate a bank's ability to monitor and address risk issues when they arise.
- **Rapid Growth**: Partnerships can lead to rapid growth in deposits or payments volume. Banks may have trouble scaling their risk management capabilities fast enough to keep pace with the growth in the volume and complexity of their operations, which can increase the chance of risk management failures, including regulatory violations.
- **Funding Concentrations**: Partnerships can result in significant concentrations that challenge a bank's ability to manage liquidity risks, particularly if funding is deployed in illiquid or long-term assets or if a large partnership suddenly ends.
- **Customer Confusion**: When a fintech is an intermediary between a bank and its customers, the customers may not know that the fintech they are interacting with is not itself a bank, particularly when the fintech refers to FDIC insurance in its marketing. Customers may not understand that deposit insurance does not protect against the fintech's failure.
- **Data Use and Ownership**: The division of roles between a bank and a fintech can create issues around data ownership, particularly in regard to the bank managing its operations and meeting compliance obligations. Therefore, it is important for the bank to have access to its data held at the fintech. If the bank cannot access its data, the bank faces multiple challenges, including challenges related to customer account recordkeeping and Bank Secrecy Act/anti-money laundering compliance.

CONCLUSION

The comment period for the RFI has closed. The Federal Reserve and the other federal banking agencies are reviewing the public comments and appreciate the thoughtfulness of these comments and the time taken to make them. The agencies continue to devote considerable effort to building on their understanding of complex bank–fintech partnerships and addressing the related risks to help ensure that community banks can innovate in a safe and sound manner.[4] ■

Endnotes*

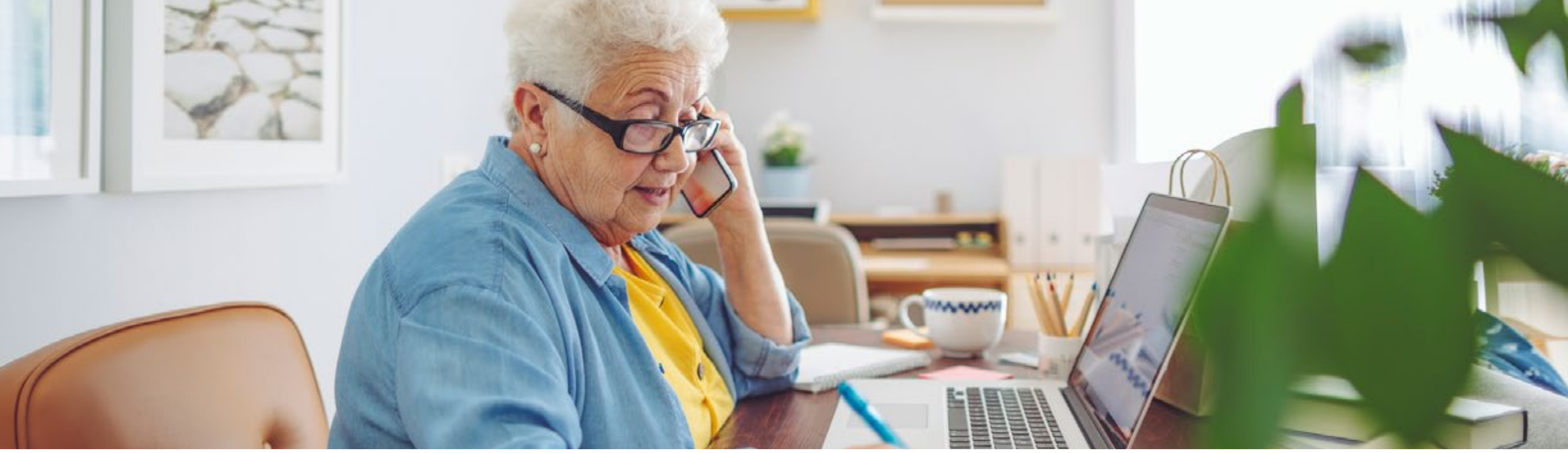
1 Partnerships may be structured as a direct relationship between a bank and a customer-facing fintech, or they may involve a separate intermediating entity that connects the bank and the fintech.

2 Complex bank–fintech partnerships are included within the scope of SR letter 23-7, "Creation of Novel Activities Supervision Program," and the Novel Activities Supervision Program.

3 This is not an exhaustive list of the risks associated with complex bank–fintech partnerships. Banks should consider the individual facts and circumstances of each partnership and conduct a comprehensive risk assessment to identify the relevant risks.

4 Additional resources for community banks' arrangements with third parties include SR letter 24-2/Consumer Affairs letter 24-1, "Third-Party Risk Management: A Guide for Community Banks"; *Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks;* and *Community Bank Access to Innovation Through Partnerships.*

* Note: The links for the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at consumercomplianceoutlook.org.



Interagency Statement on Elder Financial Exploitation

To help regulated institutions respond to the increasing problem of elder financial exploitation, the Board of Governors of the Federal Reserve System (Board), Consumer Financial Protection Bureau (CFPB), Federal Deposit Insurance Corporation (FDIC), Financial Crimes Enforcement Network (FinCEN), National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC), and state financial regulators issued a joint statement that provides examples of risk management and other practices that can be effective in identifying, preventing, and responding to this issue.[1]

This statement does not replace previous guidance, does not interpret or establish a compliance standard, and does not impose new regulatory requirements or establish new supervisory expectations. Instead, it is intended to raise awareness and provide strategies for combating elder financial exploitation, consistent with applicable legal requirements.

BACKGROUND

Elder financial exploitation is the illegal use of an older adult's funds or other resources for the benefit of an unauthorized recipient.[2] Elder financial exploitation can deprive older adults of their life savings in whole or in part, devastate their financial security, and cause other harm.

A recent study estimates annual losses from U.S. older adults as a result of elder financial exploitation at $28.3 billion.[3] The U.S. Department of the Treasury's 2024 National Money Laundering Risk Assessment described elder financial exploitation as a growing money laundering threat, which has been linked to more than $3 billion in reported financial losses annually.[4] Furthermore, a FinCEN review of Bank Secrecy Act (BSA) report data found that financial institutions filed 155,415 reports related to elder financial exploitation between June 15, 2022, and June 15, 2023, associated with more than $27 billion in reported suspicious activity, which may include both actual and attempted transactions.[5] In addition to financial losses, elder financial exploitation can result in increased reputational, operational, compliance, and other risks for supervised financial institutions (for convenience, we refer to them as banks).[6]

To help mitigate these risks, the joint statement offered the following suggestions.

GOVERNANCE AND OVERSIGHT

A number of laws and regulations related to consumer protection and safety and soundness may apply to elder financial exploitation.[7] Within this framework, a bank's oversight strategies may include policies and practices to better protect customers and the bank from elder financial exploitation.

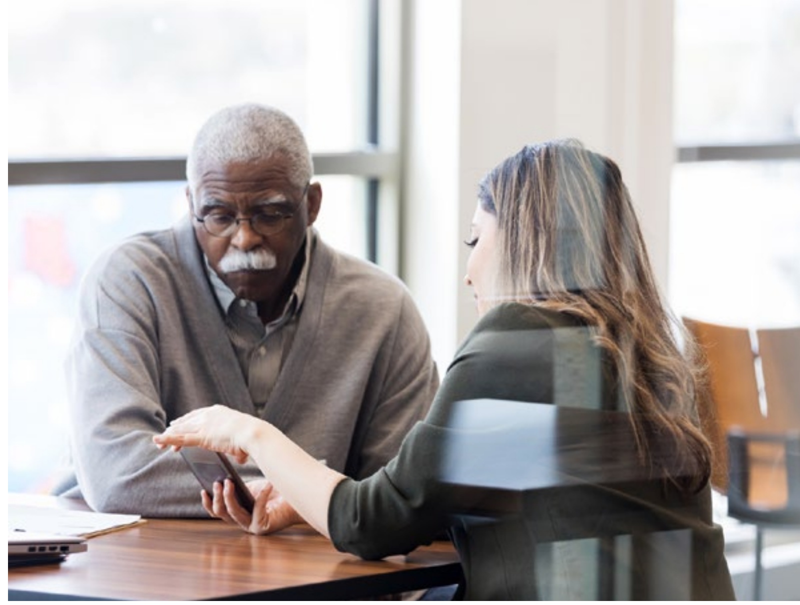
Banks may consider enhancing or creating risk-based policies, internal controls, employee codes of conduct, ongoing transaction monitoring practices, and complaint processes to identify, measure, control, and mitigate elder financial exploitation, provided such policies do not result in age discrimination that is impermissible under the Equal Credit Opportunity Act (ECOA).[8]

Effective actions include open lines of communication among departments responsible for researching and responding to unusual account activity, for example, across functions such as BSA, compliance, fraud prevention, and consumer protection, including fair lending. Compliance with applicable privacy or other legal requirements is necessary to ensure that the information of account holders remains confidential and secure.

EMPLOYEE TRAINING

Banks may find it beneficial to provide clear, comprehensive, and recurring training on how to recognize and respond to elder financial exploitation.[9] Employee training may include identifying red flags for different types of financial exploitation, providing proactive approaches to detecting and preventing elder financial exploitation, and detailing actions for employees to take when they have concerns. Customer-facing employees may be trained to identify transactional and behavioral red flags when conducting transactions for older adults, including via powers of attorney or other agents.[10] Employees may also benefit from detailed escalation processes and written procedures that promote timely action for events they are most likely to encounter in their roles.

Federal law provides that a financial institution and certain employees are not liable in any civil or administrative proceeding for disclosing suspected elder financial exploitation to covered agencies if the financial institution has timely trained its employees on identifying elder financial exploitation.[11]



USING TRANSACTION HOLDS AND DISBURSEMENT DELAYS

Banks have used transaction holds and disbursement delays to prevent consumer losses and respond to various situations that may involve elder financial exploitation. These actions must comply with applicable laws and regulations.[12]

Some state laws permit banks to temporarily hold a transaction or delay a disbursement of funds when they suspect any type of financial exploitation, including elder fraud.[13] These statutes generally provide timelines for transaction holds, and some provide immunity for institutions and employees who meet specific requirements.

It may be helpful for banks to consider various factors, such as the account holder's explanation of the purpose of the transaction; the requirements to provide disclosures; and the prohibitions against unfair, deceptive, or abusive acts or practices. Banks may also consider procedures for older adult account holders and their designated representatives to establish the legitimacy of a potentially suspicious transaction.

USING TRUSTED CONTACTS

Banks can establish policies and procedures to enable account holders to designate one or more trusted persons employees can contact when elder financial exploitation is suspected.[14] For example, an account holder might identify one or more family members, attorneys, accountants, or other trusted individuals and authorize the bank to contact them if the bank cannot reach the account holder or suspects that the account holder may be at risk of financial exploitation.[15] Unless separately authorized by the account holder, a third-party trusted contact typically would not have authority to view account information or execute transactions.

If a bank establishes a trusted contact designation process for account holders, it may be beneficial to develop clear and effective procedures for when and how to disclose to the account holder and trusted contact that one or more transactions have indicated that elder financial exploitation may be occurring.[16] Any disclosures to account holders or trusted contacts must comply with applicable privacy laws and legal prohibitions, including the confidential nature of suspicious activity reports (SARs).[17]

FILING SARs INVOLVING SUSPECTED ELDER FINANCIAL EXPLOITATION

In certain circumstances, banks must file SARs related to suspicious activity and suspected violations of law or regulation, which may include fraud and elder financial exploitation.[18] Banks can also voluntarily file SARs for suspicious activities related to elder financial exploitation that do not meet the requirements for mandatory filing, such as those involving dollar amounts lower than the regulatory threshold.[19]

Banks can consider how to detect and identify possible red flag indicators of suspected elder financial exploitation, such as unusual behavior of an older adult or their caregiver or an unexpected, large wire transfer out of an account that has no history of similar activity. FinCEN's 2022 Advisory on Elder Financial Exploitation provides examples of financial and behavioral red flags.[20] Banks can include any observed red flags of financial exploitation in the narrative section of the SAR to describe the reasons why the activity is suspicious.[21]

FinCEN's 2022 advisory also requests that financial institutions mark the elder financial exploitation checkbox (SAR Field 38(d)) and include "EFE FIN-2022-A002" in SAR Field 2 (Filing Institution Note to FinCEN) and in the narrative to indicate when elder financial exploitation is suspected.[22] This approach provides potentially useful information to law enforcement and supports accurate elder financial exploitation SAR data analysis and trend tracking.[23]

Banks are reminded that federal law prohibits them from disclosing a SAR and any information that would reveal its existence, except in authorized circumstances.[24] No bank and no current or former director, officer, employee, or agent of a financial institution that reports a suspicious transaction may notify any person involved in the transaction that the transaction has been reported or otherwise reveal any information that would reveal that the transaction has been reported.[25]

REPORTING TO LAW ENFORCEMENT, ADULT PROTECTIVE SERVICES, OR OTHER ENTITIES, AS APPROPRIATE

Timely reporting of elder financial exploitation increases the likelihood of successful recovery of funds. In 2013, the CFPB, Commodity Futures Trading Commission (CFTC), FDIC, Board, Federal Trade Commission (FTC), NCUA, OCC, and Securities and Exchange Commission (SEC) issued joint guidance to confirm that the privacy provisions of the Gramm–Leach–Bliley Act generally do not prevent financial institutions from reporting elder financial exploitation to appropriate local, state, or federal agencies.[26]

Some state laws require certain banks to report suspected elder financial exploitation to Adult Protective Services (APS), local law enforcement, or regulatory authorities.[27]

In states without mandatory reporting, banks may be able to voluntarily report suspected elder financial exploitation to relevant state or local authorities. Voluntarily notifying law enforcement directly of suspected elder financial exploitation and the underlying facts may expedite and assist law enforcement investigation and prosecution.[28]

In addition to filing various reports, banks can consider establishing procedures for referring individuals who may be victims of elder financial exploitation to the U.S. Department of Justice (DOJ)'s National Elder Fraud Hotline (833-372-8311) for assistance with reporting to the appropriate government agencies.[29] Banks may also consider informing older adults about the options for reporting elder financial exploitation to local law enforcement, the FTC, the FBI's Internet Crime Complaint Center (IC3), the U.S. Postal Inspection Service (USPIS), the Social Security Administration (SSA), or other federal, state, or local agencies.[30]

Some agencies or programs may be able to help victims recover stolen funds. For example, the IC3 Recovery Asset Team is a domestic program designed to "streamline communication with financial institutions and assist FBI field

ELDER FINANCIAL EXPLOITATION RESOURCES FROM FEDERAL AGENCIES

Federal Reserve System

- *Consumer Compliance Outlook*: Combating Elder Financial Abuse (2017)
- Philadelphia Fed: Combining Forces to Combat Elder Financial Victimization (2018)
- Chicago Fed: Preventing Elder Financial Exploitation: Research, Policies, and Strategies (2024)
- Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults (2013)

CFPB

- Recovering from Elder Financial Exploitation: A Framework for Policy and Research (2022)
- Recommendations for Financial Institutions on Implementing Trusted Contacts (2021)
- Suspicious Activity Reports on Elder Financial Exploitation: Issues and Trends (2019)
- Reporting of Suspected Elder Financial Exploitation by Financial Institutions (2019)
- Recommendations on Preventing and Responding to Elder Financial Exploitation (2016)

Other Federal Agencies

- DOJ: Annual Report to Congress on Activities to Combat Elder Fraud and Abuse (2023)
- FBI: How We Can Help You: Elder Fraud
- FinCEN: FinCEN Issues Analysis on Elder Financial Exploitation (2024)
- FinCEN: Advisory on Elder Financial Exploitation (2022)
- FTC: Protecting Older Consumers 2022–2023, Report to Congress (2023)
- FTC: Financial Institution Transaction Holds (chart of state laws) (2024)

offices with the freezing of funds for those who made transfers to domestic accounts under fraudulent pretenses."[31] Another example is FinCEN's international Rapid Response Program that "helps victims and their financial institutions recover funds stolen as the result of certain cyber-enabled financial crime schemes, including business e-mail compromise."[32]

PROVIDING FINANCIAL RECORDS TO APPROPRIATE AUTHORITIES

In addition to the reporting procedures that have been discussed, in some instances and consistent with applicable law, banks may expedite documentation requests for APS, law enforcement, or other investigatory agencies for active elder financial exploitation cases.[33]

For information on providing supporting documentation for financial records that are associated with a SAR filing, please refer to FinCEN's FAQs.[34] "Supporting documentation" refers to all documents or records that assisted a bank in making the determination that certain activity required a SAR filing.[35]

ENGAGING WITH ELDER FRAUD PREVENTION AND RESPONSE NETWORKS

Banks may also help protect older adults from financial exploitation by engaging with elder fraud prevention and response networks that include professionals from various agencies and organizations.[36] These networks are often cross-disciplinary, collaborative efforts to protect older adults from financial exploitation.

These networks can help improve coordination among banks, law enforcement, APS, local aging service providers, and other key partners.[37] Networks can also help banks engage in professional cross-training, multidisciplinary case review and coordination, and community education efforts related to elder financial exploitation.

CONSUMER OUTREACH AND AWARENESS

When consumers are informed about specific types of scams and understand perpetrators' tactics, they are less likely to engage with a perpetrator or lose money.[38] Banks can help protect their account holders by providing timely information about trending scams and ways to avoid them.[39]

Many federal, state, and local government agencies, as well as nonprofit organizations, trade associations, and other groups, provide free educational resources for consumers and caregivers about preventing elder financial exploitation. Banks are encouraged to share free resources provided by government agencies with their account holders or as part of community outreach and awareness efforts. For examples of these resources, see Appendix A in the interagency statement and the Resources box accompanying this article. ■

Endnotes*

1 Supervision and Regulation letter 24-8/Consumer Affairs letter 24-6, "Interagency Statement on Elder Financial Exploitation" (December 5, 2024).

2 The Older Americans Act, as amended by the Elder Justice Act of 2009, defines elder financial exploitation as "the fraudulent or otherwise illegal, unauthorized, or improper act or process of an individual, including a caregiver or fiduciary, that uses the resources of an elder for monetary or personal benefit, profit, or gain, or that results in depriving an elder of rightful access to, or use of, benefits, resources, belongings, or assets." 42 U.S.C. §1397j(8). FinCEN differentiates between two types of elder financial exploitation, stating, "Elder theft involves the theft of an older adult's assets, funds, or income by a trusted person. Elder scams involve the transfer of money to a stranger or imposter for a promised benefit or good that the older adult did not receive." FinCEN, Financial Trend Analysis: Elder Financial Exploitation: Threat Pattern & Trend Information, June 2022 to June 2023 (April 2024).

3 Jilenne Gunther, AARP, The Scope of Elder Financial Exploitation: What It Costs Victims (June 2023).

4 U.S. Department of the Treasury, 2024 National Money Laundering Risk Assessment (February 2024).

5 FinCEN, Financial Trend Analysis, at p. 1. As noted in the analysis, this figure may be overstated because it could include attempted or unpaid transactions, duplicates, both inbound and outbound transactions, transfers between accounts, and errors as submitted by filers, as well as reports of continuing suspicious activity or amendments to earlier reporting that would include amounts from earlier reports.

6 A 2019 CFPB study of SARs found that filing institutions reported institutional losses in 9 percent of those filings. CFPB, Suspicious Activity Reports on Elder Financial Exploitation: Issues and Trends (February 2019).

7 Examples include the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, Section 5 of the FTC Act, the Dodd–Frank Wall Street Reform and Consumer Protection Act, ECOA, and the BSA.

8 15 U.S.C. §§1691(a)(1), (b)(2)–(4). ECOA generally prohibits discrimination in any aspect of a credit transaction on the basis of age, and its implementing regulation, Regulation B, offers special protections to those 62 or older. 12 C.F.R. Part 1002.2(o), 1002.6(b)(2); 12 C.F.R. Part 1002, Supp. I, Part 1002.6(b)(2)-1.

Endnotes*

[9] CFPB's 2016 Recommendations and Report for Financial Institutions on Preventing and Responding to Elder Financial Exploitation identified promising practices to assist banks and credit unions with their voluntary efforts to prevent elder financial abuse, including general principles for training staff.

[10] FinCEN, FIN-2022-A002: Advisory on Elder Financial Exploitation (June 15, 2022).

[11] 12 U.S.C. §3423(a)(2)(B), commonly referred to as the Senior Safe Act. *Consumer Compliance Outlook* (*CCO*) summarized the act in "Compliance Spotlight: Senior Safe Act" (First Issue 2020).

[12] Bank regulators have taken enforcement actions related to restrictions on account access. See Board of Governors, Order to Cease and Desist 24-005-B-SM, in the Matter of Green Dot Bank (July 19, 2024); CFPB, Consent Order 2023-CFPB-0019, in the Matter of U.S. Bank, N.A. (December 19, 2023); OCC, Consent Order No. AA-ENF-2023-64, in the Matter of U.S. Bank, N.A. (December 19, 2023).

[13] FTC, Financial Institution Transaction Holds (October 2024). See also CFPB, Reporting of Suspected Elder Financial Exploitation by Financial Institutions (July 2019).

[14] CFPB, Financial Institutions Can Help Prevent Elder Financial Exploitation with Alerts to Trusted Contacts (November 2021*);* see also CFPB, Choosing a Trusted Contact Person Can Help You Protect Your Money (November 2021).

[15] See FINRA, Investment Accounts: Brokerage Accounts: Trusted Contacts. The North American Securities Administrators Association, the SEC, and FINRA created a training presentation about this topic. See FINRA, Is Your Financial Firm Asking You for a Trusted Contact?

[16] Trusted contacts have been widely implemented by investment firms and broker-dealers, as required by FINRA Rule 4512. See FINRA, Trusted Contact Persons: New for 2022: Regulatory Obligations and Related Considerations (2022); FINRA, Frequently Asked Questions Regarding FINRA Rules Relating to Financial Exploitation of Senior Investors.

[17] See, e.g., 31 U.S.C. §5318(g)(2); 31 C.F.R. §1020.320(e).

[18] See 12 C.F.R. Part 353; 12 C.F.R. §21.11; 12 C.F.R. §163.180(d); and 12 C.F.R. §748.1(d), issued under the authority of the BSA and 12 U.S.C. §1818, 12 U.S.C. §1819, and 12 U.S.C. §1786(q). The BSA defines the term "financial institution" for this purpose. 31 U.S.C. §5312(a)(2). FinCEN maintains these reports and records in its BSA database and makes them available to authorized users from law enforcement, intelligence, and regulatory agencies. FinCEN provides such access consistent with the BSA, FinCEN's implementing regulations, and Memoranda of Understanding that agencies enter into with FinCEN before accessing BSA data, which set out safeguards for the access to and use of BSA reports. See 31 U.S.C. §5318(g); 31 C.F.R. §§1020.320, 1021.320, 1022.320, 1023.320, 1024.320, 1025.320, 1026.320, 1029.320, and 1030.320. "A financial institution is required to file a SAR if it knows, suspects, or has reason to suspect a transaction conducted or attempted by, at, or through the financial institution involves funds derived from illegal activity, or attempts to disguise funds derived from illegal activity; is designed to evade regulations promulgated under the BSA; lacks a business or apparent lawful purpose; or involves the use of the financial institution to facilitate criminal activity, including EFE [elder financial exploitation]." FinCEN 2022 advisory, at p. 11.

[19] "All statutorily defined financial institutions may voluntarily report suspicious transactions under the existing suspicious activity reporting safe harbor." Id. (citing 31 U.S.C. §5318(g)(3)).

[20] FinCEN's 2022 advisory requests that financial institutions include all available information relating to the account and locations involved in the reported activity, identifying information and descriptions of any legal entities or arrangements involved and associated beneficial owners, and any information about related persons or entities involved in the activity.

[21] See id.; see also FinCEN, FIN-2011-A003: Advisory to Financial Institutions on Filing Suspicious Activity Reports Regarding Elder Financial Exploitation (February 22, 2011).

[22] See id.

[23] See id.; CFPB, "Data Spotlight: Suspicious Activity Reports on Elder Financial Exploitation"; CFPB SARs 2019.

[24] 31 U.S.C. §5318(g).

[25] 31 U.S.C. §5318(g)(2)(A)(i); 31 C.F.R. §1020.320(e)(1)(ii); 12 C.F.R. §21.11(k); 12 C.F.R. §163.180(d)(12).

[26] The Board, CFTC, CFPB, FDIC, FTC, NCUA, OCC, and SEC, Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults (September 24, 2013).

[27] Different states' APS agencies may have varying organizational structures for responding to suspected abuse of different age groups within the adult population. National Adult Protective Services Association, Get Help: Help in Your Area.

[28] Banks are reminded that reporting suspicious activity to law enforcement does not relieve the financial institution of the requirement to file a SAR with FinCEN. See 31 C.F.R. §1020.320(b)(3); 12 C.F.R. §21.11(d); 12 C.F.R. §748.1(d)(2)(i); 12 C.F.R. §163.180(d)(5).

[29] FinCEN, FinCEN Reminds Financial Institutions to Remain Vigilant to Elder Financial Exploitation (June 14, 2024).

[30] FinCEN, Fact Sheet on the Rapid Response Program (February 11, 2022); FTC, Report to Help Fight Fraud!; FBI, Internet Crime Complaint Center (IC3); USPIS, Our Investigation Starts with Your Report; SSA Office of the Inspector General, Report Fraud; CFTC, Submit a Tip; SEC, Report Suspected Securities Fraud or Wrongdoing.

[31] Internet Crime Complaint Center, Federal Bureau of Investigation Internet Crime Report 2023 (2023).

[32] See FinCEN, FinCEN's Rapid Response Program Aids in Recovering More Than $1.1B Since Inception (February 14, 2022); FinCEN, FIN-2022-FCT1: Fact Sheet on the Rapid Response Program (RRP) (February 11, 2022).

[33] The CFPB, the Treasury, and FinCEN issued a joint memorandum to encourage coordination among financial institutions, law enforcement, and APS agencies to protect older adults from elder financial exploitation. The Treasury, FinCEN, and the CFPB, Memorandum on Financial Institution and Law Enforcement Efforts to Combat Elder Financial Exploitation (August 30, 2017).

[34] Regarding SAR filings, banks should make all supporting documentation available to FinCEN or any federal, state, or local

Endnotes*

law enforcement agency, or any federal regulatory authority that examines the bank for compliance with the BSA or any state regulatory authority administering a state law that requires the bank to comply with the BSA or otherwise authorizes the state authority to ensure that the institution complies with the BSA, upon request. 31 C.F.R. §1020.320(d); see also FinCEN, Suspicious Activity Report Supporting Documentation: FIN-2007-G003 (June 13, 2007); FinCEN, Frequently Asked Questions Regarding the FinCEN Suspicious Activity Report (SAR).

[35] FinCEN SAR supporting documentation.

[36] CFPB, Elder Fraud Prevention Network Development Guide.

[37] Banks can consult the DOJ's Elder Justice Network Locator Map to find and join existing networks or use the Administration for Community Living's Eldercare Locator tool to contact a local APS agency or Area Agency on Aging for help identifying a network. Additionally, banks can use CFPB's Network Development Guide to help their communities form a new network or grow an existing network.

[38] FINRA Foundation, Exposed to Scams: Can Challenging Consumers' Beliefs Protect Them from Fraud? (September 2021).

[39] The agencies offer publications that regularly spotlight fraud issues and educate older consumers about how to prevent fraud. See, e.g., OCC, Financial Literacy Update: Third Quarter 2024. See also Acting Comptroller of the Currency Michael J. Hsu, Remarks for the Financial Literacy and Education Commission's Public Meeting: Banks' Role in Addressing Fraud Against Consumers (July 10, 2024).

* Note: The links for the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at consumercomplianceoutlook.org.

THANK YOU, ALINDA MURPHY AND DOLORES COLLAZO

In 2017, *Consumer Compliance Outlook* (*CCO*) created a writers' cohort of supervisory staff at the Reserve Banks and Federal Reserve Board to contribute articles to *CCO*. This year, Alinda Murphy and Dolores Collazo are leaving the cohort after several years of service. We want to thank them and acknowledge their contributions.

Alinda is a lead examiner at the Federal Reserve Bank of Kansas City. She joined the cohort in 2017 and has published the following articles:

- "Consumer Complaints 2023: A Review of Federal Reserve Data" (Second Issue 2024)
- "Common Challenges of Community Bank Compliance Officers" (First Issue 2023)
- "Top Federal Reserve Compliance Violations in 2022: Data Collection and Reporting Requirements of the Home Mortgage Disclosure Act" (Second–Third Issue 2023)
- "Mortgage Servicers' Duties Under Regulation X to Respond to Notices of Error and Requests for Information" (Third Issue 2021)
- "Effective Bank Communications Enhance Compliance" (Third Issue 2020)
- "Don't Forget About These Federal Consumer Protection Laws and Regulations" (First Issue 2019)

Dolores is a senior financial institution policy analyst at the Federal Reserve Board. She joined the cohort in 2020 and has published the following articles:

- "Top Federal Reserve Compliance Violations in 2022 Under the Fair Credit Reporting Act and the Equal Credit Opportunity Act (Fourth Issue 2023)
- "Digital Banking Compliance Considerations" (First Issue 2023)
- "Advanced Topics in Adverse Action Notices Under the Equal Credit Opportunity Act" (Fourth Issue 2021)
- "HELOC Plans: Compliance and Fair Lending Risks When Property Values Change" (Third Quarter 2013)

Alinda and Dolores: Thank you for participating in the cohort and writing articles that provide helpful outreach to the banking industry on consumer compliance topics!

CONTINUED FROM PAGE 1

The Federal Reserve System's Top-Issued Fair Lending Matters Requiring Immediate Attention and Matters Requiring Attention

- issues that could pose significant risk to the safety and soundness of the banking organization.

MRIAs must be resolved as quickly as possible. But for "heightened safety-and-soundness or consumer compliance risk,"[2] they must be addressed immediately. The institution must also respond in writing to the MRIA indicating its plan for corrective action.

MRAs

MRAs raise important issues but do not pose an immediate risk and are expected to be addressed in a reasonable period of time. "The key distinction between MRIAs and MRAs is the nature and severity of matters requiring corrective action, as well as the immediacy with which the banking organization must begin and complete corrective action."[3]

FAIR LENDING MRIAs/MRAs

The Federal Reserve evaluates SMBs for fair lending risk at every consumer compliance examination. For SMBs with less than $10 billion in assets, the Federal Reserve examines for compliance with both the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA). For institutions over $10 billion in assets, the Federal Reserve examines for compliance with the FHA, while the Consumer Financial Protection Bureau (CFPB) examines for compliance with ECOA, as required by the Dodd–Frank Act.[4]

ECOA prohibits discrimination in consumer and commercial credit transactions on the prohibited bases of race, color, religion, national origin, sex, marital status, age, the receipt of income from a public assistance program, and the good faith exercise of rights under the Consumer Credit Protection Act.[5] The FHA prohibits discrimination in residential housing transactions on the prohibited bases of race, color, religion, sex, handicap, familial status, or national origin.[6]

TOP FAIR LENDING MRIAs/MRAs FOR STATE MEMBER BANKS IN 2022

Matter #1 – Failing to Conduct Fair Lending Risk Assessments

Supervisory Expectation

An institution's overall fair lending risk management program should be commensurate with the size, complexity, and fair lending risk profile of its lending. Supervisors expect institutions with heightened fair lending risk to conduct a fair lending risk assessment to ensure the risk is being appropriately measured and mitigated. For example, if a bank with many majority-minority census tracts[7] in its assessment area is not conducting a fair lending risk assessment, its risk of fair lending violations increases.

Root Cause

Some institutions with heightened fair lending risks relied on their compliance risk assessments to measure fair lending risk. However, when an institution has elevated fair lending risk, an overall compliance risk assessment can be inadequate to measure fair lending risk because it is more general and less focused and nuanced than a fair lending risk assessment and may fail to identify risks that would have been identified in a fair lending risk assessment.

Sound Practice

Institutions with heightened fair lending risk can mitigate this risk by implementing fair lending risk assessments. These assessments are typically conducted annually, but could be updated following a major fair lending event, such as a merger or acquisition that added majority-minority census tracts to the lender's assessment area. The assessment should be tailored to an institution's fair lending risk profile and assess its inherent risks, controls to mitigate those risks, and the resulting residual risk. Inherent risk arises from the general conditions or the environment in which the institution operates. Factors that can inform an inherent risk assessment include:

- supervisory history (past violations and concerns);
- loan portfolio (especially the volume for each loan product);
- structure and management (decentralization and discretion); and
- markets (significant minority populations).

Examiners use the risk factors in the *Interagency Fair Lending Examination Procedures* to scope out fair lending examinations, which may include evaluating risk for:[8]

- marketing;
- overt statements or policies;

> The goal of a risk assessment is to identify and mitigate the residual risk that remains after identifying fair lending risk *and* the controls implemented to mitigate the risks.

- steering;
- pricing;
- underwriting;
- redlining; and
- the compliance management system.

Fair lending controls should be considered in conducting the fair lending risk assessment. The goal of a risk assessment is to identify and mitigate the residual risk that remains after identifying fair lending risk *and* the controls implemented to mitigate the risks. For example, if an institution was cited in a report of examination for failing to adequately explain the reason for taking adverse action, and it responded by requiring a second review of all notices, the risk assessment would find this fair lending risk has been mitigated. Again, the number and formality of controls vary based on size, complexity, and fair lending risk profile, but may include some combination of the following illustrative (but not exhaustive) list of controls:

- policies and training that set expectations of fair lending;
- controls to limit loan officer discretion;
- objective standards for pricing and underwriting;
- requirements to document decisions and exceptions;
- second reviews for denials; and
- procedures that escalate findings to the board and senior management.

After identifying and evaluating each control's effectiveness relative to the inherent risks, the risk assessment can analyze the residual risk for each identified fair lending risk. If the risk assessment finds more than minimal inherent risk, the compliance officer may consider performing additional analysis, such as comparative file reviews. In most instances, the expectation is that the risk assessment would be updated and approved annually by the board of directors.

Matter #2 – Failing to Conduct Fair Lending Training

Supervisory Expectation

Effective, complete, and recurring training is an essential part of a fair lending compliance management program. For example, if a loan officer is aware that it can require a guarantor or cosigner when an applicant does not meet underwriting standards, but is not aware that it cannot require that it be the applicant's spouse,[9] the risk of a spousal signature violation under Regulation B increases.

Additionally, like all legal compliance risks, fair lending risks can change over time. An effective change management process includes properly training staff regarding the relevant change.

Root Cause

Compliance departments can become complacent and overlook the benefits of recurring fair lending training, especially for board members and management.

Sound Practice

Banks can provide recurring fair lending training to all lending staff, management, and the board of directors. The training should be appropriate and tailored to the position receiving the training. Training can help lending staff to understand prohibited activities, management to be aware of fair lending risk, and the board to set the correct tone. Because training is intended to emphasize values and keep risks top of mind, fair lending training is most effective when it is recurring, often annually. Training provides banks with an opportunity to promote their culture and set expectations about appropriate conduct.

Matter #3 – Failing to Gross Up Nontaxable Income When Underwriting Is Based on Gross Income

Legal and Regulatory Requirement

ECOA and the FHA prohibit discrimination in all aspects of the transaction, including when evaluating applicants for credit. Lenders' underwriting systems typically analyze either an applicant's *gross* or *net* income. If a lender's system analyzes *gross* income and fails to gross up the income when the applicant's income is nontaxable, the practice raises fair lending risk. It may result in discounting an applicant's income on a prohibited basis,[10] and could also result in discriminatory loan denials due to insufficient income. Suppose, for example, a lender will not approve mortgage loans for applicants with a debt-to-income ratio greater than 40 percent, and the lender analyzes gross income and does not gross up nontaxable income when computing the ratio. An applicant's nontaxable, monthly disability income is $3,000, his monthly debt payments total $1,500, and his effective tax rate is 25 percent, showing a debt-to-income ratio of 50 percent. This applicant would be denied a mortgage loan using this lender's standards. But if the lender grossed up his income of $3,000 based on his 25 percent tax rate, his qualifying income would be considered to be $4,000 and his debt-to-income ratio would be 37.5 percent. This applicant would have been approved under the bank's policy but for the failure to gross up his income. A policy of not grossing up nontaxable income, such as nontaxed Social Security Disability Income, may result in a finding of illegal discrimination, as receipt of public assistance income is a protected characteristic under ECOA, as is disability under the FHA.

> "Loan officer discretion can increase the risk of a fair lending violation. It is therefore important to implement controls to mitigate this risk."

Root Cause

The primary reason banks fail to gross up nontaxable income is that they do not have policies and procedures in place that require underwriters to gross up nontaxable income when underwriting is based on gross income. Banks have been especially likely to maintain this policy or practice of calculating income for products not subject to investor standards that require gross-up of income, such as the standards of Fannie Mae and Freddie Mac.

Sound Practice

Compliance departments can review loan policies to see if they properly address this issue and, if not, adjust the policies. In this example, lenders had to develop procedures to ensure that nontaxable income is consistently grossed up to an "adjusted gross income" for the initial evaluation of debt-to-income and used for the underwriting decision for all underwriting that relies on gross income.

Matter #4 – Risk Monitoring and Management Information System (Exception Monitoring)

Supervisory Expectation

Loan officer discretion can increase the risk of a fair lending violation. It is therefore important to implement controls to mitigate this risk. If loan officers have discretion, it should be monitored to ensure it is not exercised on a prohibited basis — especially in pricing or underwriting. Risk monitoring and reporting provide the board and management with the information needed to identify and evaluate fair lending risks.

Root Cause

Institutions failed to implement a control to ensure loan officers' discretionary credit decisions do not violate fair lending laws. While having clear, written, objective pricing and underwriting criteria helps to limit lender discretion, allowing loan officers to make exceptions to those rules can increase fair lending risk. The fair lending risk can become a fair lending violation if those exceptions are applied unevenly, as the bank may be disproportionately providing accommodations, exceptions, or more favorable terms and conditions on a prohibited basis. A control is necessary to ensure the exercise of the discretion complies with fair lending laws.

Sound Practices

Banks can employ different strategies for mitigating the risk of loan officer exceptions to pricing and underwriting standards. One option is to eliminate discretion by stating in the loan policy that exceptions are not permitted. While this approach benefits from its simplicity, some banks find the solution does not fit with broader business strategies. Alternatively, banks that allow loan officers to retain discretion to make exceptions to policy can mitigate that risk by tracking and maintaining oversight over how loan officers use those exceptions. In this case, sound practices include establishing a written, clear policy setting forth reasons for exceptions, specifying the factors for which an exception is permitted, and retaining documentation. Another sound practice is to maintain oversight over loan officers' use of discretion by tracking and monitoring exceptions (including frequency and amount/magnitude) to confirm that the exceptions do not result in potential disparities on a prohibited basis. Finally, lenders can train loan officers on how to exercise their discretion without violating fair lending laws.

CONCLUDING REMARKS

Fair lending MRIAs and MRAs are among the most common matters issued throughout the Federal Reserve System. While banks are responsible for all aspects of their fair lending compliance management program, compliance officers may benefit from reviewing these more frequently issued matters and comparing them to their current practices. Banks should raise specific fair lending issues and questions with their primary regulator. ■

Endnotes*

[1] SR 13-13/CA 13-10, "Supervisory Considerations for the Communication of Supervisory Findings" ("Supervisory Communications") (June 17, 2013).

[2] Supervisory Communications at p. 3.

[3] Federal Reserve Board Commercial Bank Examination Manual at p. 21 (October 2023).

[4] 12 U.S.C. §5515. The CFPB enforces "federal consumer financial laws," as defined in the Dodd–Frank Act, which does not include the FHA. See 12 U.S.C. §5481(14).

[5] 15 U.S.C. §1691(a); 12 C.F.R. §1002.4(a).

[6] 42 U.S.C. §3605(a); 24 C.F.R. Part 100.

[7] In a fair lending review in a consumer compliance examination, unless otherwise noted, "majority-minority census tracts" are defined as census tracts that are more than 50 percent Hispanic and African-American.

[8] *Interagency Fair Lending Examination Procedures* (2009).

[9] 12 C.F.R. §1002.7(d)(5); "If, under a creditor's standards of creditworthiness, the personal liability of an additional party is necessary to support the credit requested, a creditor may request a cosigner, guarantor, endorser, or similar party. The applicant's spouse may serve as an additional party, *but the creditor shall not require that the spouse be the additional party*." Emphasis added.

[10] 12 C.F.R. §1002.6(b)(5); "A creditor shall not discount or exclude from consideration the income of an applicant or the spouse of an applicant because of a prohibited basis."

* Note: The links for the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at consumercomplianceoutlook.org.

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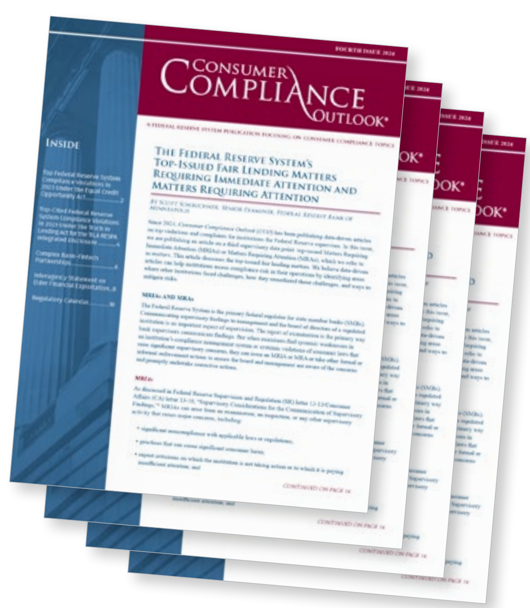

REGULATORY CALENDAR

EFFECTIVE DATE OR PROPOSAL DATE†	IMPLEMENTING REGULATION	REGULATORY CHANGE
10/01/25*	Regs. E and Z	Consumer Financial Protection Bureau (CFPB) issues final rule for overdraft fee for very large financial institutions
10/01/25*	Reg. Z	Agencies issue final rule on quality control standards for automated valuation models
07/01/25	Reg. CC	Agencies implement inflation-adjusted dollar thresholds for Regulation CC funds availability
01/17/25	12 U.S.C. §1033	CFPB issues final rule on personal financial data rights
01/09/25	12 C.F.R. §1090.109	CFPB issues larger participant final rule for the general-use digital consumer payment applications market
01/01/25	Reg. Z	Agencies announce dollar thresholds for smaller loan exemption from appraisal requirements for higher-priced mortgage loans
01/01/25	Regs. M and Z	Agencies adjust dollar thresholds for consumer credit and lease transactions
12/09/24	Reg. V	CFPB issues an advance notice of proposed rulemaking for furnishing information about coerced debt
12/03/24	Reg. V	CFPB issues proposal to define data brokers as consumer reporting agencies subject to the Fair Credit Reporting Act
07/30/24	Reg. Z	CFPB issues interpretive rule applying certain provisions of Regulation Z to Buy Now Pay Later loans
07/26/24	FHA, Regs. Z and B	Final Interagency Guidance on Reconsiderations of Value of Residential Real Estate Valuations
06/18/24	Reg. V	CFPB issues proposed rule to limit the use of medical debt in underwriting consumer credit

REGULATORY CALENDAR

EFFECTIVE DATE OR PROPOSAL DATE†	IMPLEMENTING REGULATION	REGULATORY CHANGE
05/14/24**	Reg. Z	CFPB issues final rule for credit card penalty fees
04/29/24	24 C.F.R. §100.500	Guidance on Application of the Fair Housing Act to the Advertising of Housing, Credit, and Other Real Estate-Related Transactions Through Digital Platforms
02/23/24	Regs. E and Z	CFPB issues proposal to regulate credit overdrafts at very large financial institutions
02/01/24***	Reg. BB	Agencies issue final rule to modernize their implementing regulations for the Community Reinvestment Act
01/31/24	12 C.F.R. §1042.2	CFPB issues proposal to prohibit fees for instantaneously declined transactions
11/14/23	Reg. II	Federal Reserve issues proposal to lower the maximum interchange fee a large debit card issuer may charge
10/30/23	n/a	Agencies issue principles for climate-related financial risk management for large financial institutions
10/12/23	Reg. B	CFPB and Department of Justice issue Joint Statement on Fair Lending and Credit Opportunities for Noncitizen Borrowers Under the Equal Credit Opportunity Act
09/19/23	Reg. B	CFPB issues Advisory Opinion on adverse action notice requirements for creditors using artificial intelligence
08/29/23****	Reg. B	CFPB's Statement on Enforcement and Supervisory Practices Relating to the Small Business Lending Rule Under the Equal Credit Opportunity Act and Regulation B

† Because proposed rules do not have an effective date, we have listed the *Federal Register* publication date.

* Subject to CFPB review

** A federal court in Texas issued an injunction in May 2024 staying the rule and declined in December 2024 to lift the stay.

*** In March 2024, a federal court in Texas issued an injunction staying the rule, which the agencies have appealed to the Fifth Circuit Court of Appeals.

**** A lawsuit was filed in a Texas federal court challenging the §1071 rule. In September 2024, the court held the rule was properly issued. The decision has been appealed to the Fifth Circuit.

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2025 Calendar of Events

June 10–13, 2025 — **ABA Risk and Compliance Conference**
Indiana Convention Center
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April 10–11, 2025 — **Fintech and Financial Institutions Research Conference**
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