The requirement that creditors give reasons for adverse action is ... a strong and necessary adjunct to the antidiscrimination purpose of the legislation, for only if creditors know they must explain their decisions will they effectively be discouraged from discriminatory practices. Rejected credit applicants will now be able to learn where and how their credit status is deficient and this information should have a pervasive and valuable educational benefit. Instead of being told only that they do not meet a particular creditor’s standards, consumers particularly should benefit from knowing, for example, that the reason for the denial is their short residence in the area, or their recent change of employment, or their already over-extended financial situation.

— Legislative history of Equal Credit Opportunity Act Amendments of 1976

The Equal Credit Opportunity Act (ECOA), as implemented by Regulation B, requires creditors to notify businesses and consumers applying for credit about the action taken on their applications within specified time periods. If adverse action is taken, as defined in the ECOA and Regulation B, the creditor must provide an adverse action notice (AAN) disclosing the reasons for taking adverse action, and, if a credit score was used, the key factors adversely affecting the score. As the legislative history of the ECOA quoted at the beginning of this article indicates, these notices provide transparency to the credit underwriting process and help protect applicants against potential credit discrimination by requiring creditors to specify the reasons for taking adverse action. The Fair Credit Reporting Act (FCRA) also imposes AAN requirements in certain circumstances. Unlike the ECOA, however, the FCRA applies only to consumers and more broadly applies to adverse action on certain noncredit transactions such as employment or insurance applications. Outlook published an article in 2013 on these requirements titled “Adverse Action Notice Requirements Under the ECOA and the FCRA,” which is our most viewed article.

In this follow-up article, we discuss advanced AAN requirements, including counteroffers, incomplete applications, and withdrawn applications. We also review the differences among an inquiry, prequalification, and preapproval as well as the notice requirements for...
each. In addition, we review the AAN requirements when multiple creditors are involved in a credit transaction. Finally, we discuss the emerging issue of the AAN considerations when a credit decision is based on innovative credit practices, such as credit models using alternative data sets, artificial intelligence (AI), or machine learning (ML). This article presumes the reader is familiar with our prior article, which defined adverse action and reviewed the general AAN requirements.

**COUNTEROFFER, INCOMPLETE APPLICATION, AND WITHDRAWN APPLICATION**

Situations can arise during the loan application process in which the creditor neither approves nor denies an application, including counteroffers and applications that are incomplete or withdrawn. We discuss the AAN requirements in these circumstances.

**Counteroffer**

A counteroffer occurs when a creditor is willing to grant credit but on different terms than the applicant requested. For example, the creditor’s lending standards may require a higher down payment for a mortgage loan or a shorter repayment term for a used automobile loan than the applicant requested. The regulation imposes two notice requirements for counteroffers. First, the creditor must send a notice with the terms of the counteroffer within 30 days after the creditor receives a completed application. Second, if the applicant does not expressly accept or use the credit offered within 90 days of the initial counteroffer notice, the creditor must send an AAN for the counteroffer. To reduce the compliance burden, a creditor can combine the AAN for the original application along with the counteroffer, provided the combined notice is sent within 30 days after receiving the completed application. If a creditor uses the combined notice, and the borrower does not respond within 90 days, the creditor is not required to send a second AAN. A sample of a combined counteroffer notice is provided in Appendix C to Regulation B. A sound practice is to specify a date on which the counteroffer expires; the regulation does not require a creditor to hold a counteroffer open for 90 days or any other particular time period.

**Incomplete Application**

A creditor has latitude under the regulation to determine the type and amount of information it requires from applicants to complete a credit application and must act diligently to collect information needed to complete the application. When a creditor receives an application that lacks sufficient data for a credit decision
(excluding a preapproval that qualifies as an application, which is discussed later in this article), the creditor has several options. First, a creditor may deny the application and provide an AAN specifying that an incomplete application is the reason for the denial. Second, a creditor may provide a notice of incompleteness, which must meet these requirements under §1002.9(c)(2):

- Provides a written notice to the applicant specifying the information needed;
- Designates a reasonable period of time to provide the information; and
- Informs the applicant that the application will not be considered further if the requested information is not provided.

Finally, a creditor may inform the applicant orally about providing any additional information to complete the application. If the applicant provides the requested information, the creditor must act in accordance with §1002.9(a) from the date of receiving the information. If the application remains incomplete after the oral notice, the creditor must provide either an AAN or a notice of incompleteness. Notices for incomplete applications must be provided within 30 days after receiving the application, unless notice is provided in accordance with §1002.9(c).

Responses to Notice of Incompleteness

Table 1 lists the compliance requirements when an applicant responds to a notice of incompleteness:

<table>
<thead>
<tr>
<th>Applicant's Response</th>
<th>Creditor’s Obligation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applicant provides information within the designated time period</td>
<td>The creditor must reevaluate the application and, if denied, provide an AAN within 30 days, including specific reasons for the action taken or disclose that the applicant has the right to request the reasons.</td>
</tr>
<tr>
<td>Applicant provides information after the specified deadline</td>
<td>The creditor may process the application or require that the applicant submit a new one.</td>
</tr>
<tr>
<td>Applicant fails to respond to a notice of incompleteness within the specified time</td>
<td>The compliance obligations for the notice of incompleteness are satisfied; however, the record retention requirements in 12 C.F.R. §1002.12(b)(1) still apply.</td>
</tr>
</tbody>
</table>

If an application is incomplete, but contains sufficient information to make a credit decision, and the creditor denies the application, the applicant must be advised about the specific reasons for the credit denial or notice of the right to receive the reasons. In this instance, missing information or incomplete application cannot be specified as the basis for the denial since the creditor had sufficient information to make a credit decision.

Withdrawn Application

Section 1002.9 specifies the deadlines by which a creditor must notify a credit applicant of the action taken. But if the applicant expressly withdraws the application before the applicable deadline, the notice requirements do not apply. Finally, when a loan is approved where the parties contemplated that the applicant would inquire about the loan’s status but fails to do so within 30 days of applying, the creditor may treat the application as withdrawn. No notice is required.

Compliance Tip for Withdrawn Applications

If a creditor has obtained sufficient information to make a credit decision and denies the application, it should not be treated as withdrawn because the applicant did not inquire about the status of it. An AAN is required because the creditor denied the application.
INQUIRY, PREAPPROVAL, AND PREQUALIFICATION

A consumer may shop for credit, particularly for a larger credit transaction such as a residential mortgage loan. A consumer’s interactions with a creditor while shopping can result in inquiries, preapprovals, and prequalification requests, which are technical credit terms that have different compliance requirements. It is important to understand the AAN requirements when discussing loan products and credit qualifications with potential applicants to reduce the risk of violating Regulation B.

Inquiry

When shopping for a loan, consumers often contact creditors to inquire about loan products and terms. It is important to distinguish between an application, which triggers the regulation’s notice requirements, and an inquiry, which does not. The regulation defines application as “an oral or written request for an extension of credit that is made in accordance with the procedures established by a creditor for the type of credit requested.” The Official Staff Commentary (commentary) clarifies that procedures “refers to the actual practices followed by a creditor for making credit decisions as well as its stated application procedures. For example, if a creditor’s stated policy is to require all applications to be in writing on the creditor's application form, but the creditor also makes credit decisions based on oral requests, the creditor’s procedures are to accept both oral and written applications.”

The regulation states that how a creditor responds to the consumer, and not what the consumer says or asks, determines if an inquiry becomes an application ...

Prequalification

A prequalification refers to a request to determine if an applicant would likely qualify for credit if he applied. Like an inquiry, a prequalification request can evolve into an application that must comply with the notice requirements in §1002.9, depending on the creditor’s response to the request. For example, a consumer may want to know the mortgage amount he could qualify for when shopping for a home. Generally, an AAN is not applicable if the creditor responds by telling the consumer the loan amount, rate, and other terms of credit the consumer could qualify for under various loan programs and explains the process the consumer must follow to submit a mortgage application and this to the consumer, the creditor has treated the inquiry or prequalification request as an application and must then comply with the notification requirements under §1002.9.
the information the creditor will analyze in reaching a credit decision. On the other hand, a creditor has treated a request as an application subject to adverse action notification if, after evaluating information, the creditor decides it will not approve the request and communicates that decision to the consumer.27 For example, if the creditor tells the consumer that it cannot approve a mortgage application because the consumer has a bankruptcy in his credit history, the creditor has denied an application for credit.28

Preapproval

The regulation does not explicitly define preapproval. Instead, the commentary clarifies that the definition of application includes certain preapproval requests. It provides this example of a preapproval request that is deemed an application:

A person asks a financial institution to “preapprove” her for a loan (for example, to finance a house or a vehicle she plans to buy) and the institution reviews the request under a program in which the institution, after a comprehensive analysis of her creditworthiness, issues a written commitment valid for a designated period of time to extend a loan up to a specified amount. The written commitment may not be subject to conditions other than conditions that require the identification of adequate collateral, conditions that require no material change in the applicant’s financial condition or creditworthiness prior to funding the loan, and limited conditions that are not related to the financial condition or creditworthiness of the applicant that the lender ordinarily attaches to a traditional application (such as certification of a clear termite inspection for a home purchase loan, or a maximum mileage requirement for a used car loan).29

Thus, if a consumer’s request to be preapproved for credit accords with this example, the request is deemed an application and the notice provisions of §1002.9 apply.30 The commentary also clarifies that if the creditor evaluates the applicant’s creditworthiness and determines he does not qualify for a preapproval, an AAN is required.31

Finally, if the creditor’s preapproval program does not provide written commitments, requests for preapprovals are treated as prequalification requests and are subject to the prequalification requirements discussed previously.32

APPLICATIONS SUBMITTED THROUGH A THIRD PARTY

Applicants sometimes use third parties to apply to multiple creditors. The AAN requirements in these circumstances are addressed in §1002.9(g):

When an application is made on behalf of an applicant to more than one creditor and the applicant expressly accepts or uses credit offered by one of the creditors, notifying the parties of any action taken by any of the other creditors is not required. If no credit is offered or if the applicant does not expressly accept or use the credit offered, each creditor taking adverse action must comply with this section, directly or through a third party. A third party’s notice will disclose the identity of each creditor on whose behalf the notice is given.

The regulation does not explicitly define preapproval. Instead, the commentary clarifies that the definition of application includes certain preapproval requests.

If adverse action is taken, the creditor or a noncreditor third party may provide the AAN.33 If a third party provides one notification on behalf of multiple creditors, the notice must contain the name and address of each creditor.34 The notice must either disclose the applicant’s right to receive a statement of the specific reasons within 30 days or provide the primary reasons that each creditor relied upon in taking the adverse action, clearly indicating which reasons relate to which creditor. If a single AAN is provided to an applicant on behalf of several creditors and they are under the jurisdiction of different federal enforcement agencies, the notice doesn’t need to name each agency; the disclosure of any of them is acceptable.35
For applications submitted through a third party, a creditor is not liable for an act or omission of the third party that constitutes a violation of the regulation if the creditor accurately and in a timely manner provided the third party with the information needed for the notification and maintains reasonable procedures adapted to prevent such violations.36

**Appendix C of Regulation B includes sample AAN forms that list some of the factors creditors commonly consider in taking adverse action.**

**NOTIFICATION WHEN USING ALTERNATIVE DATA OR ARTIFICIAL INTELLIGENCE/MACHINE LEARNING MODELS**

Some creditors are using emerging technologies to evaluate credit applications, including alternative data sets, such as analyzing the cash flows in a consumer’s bank account, and artificial intelligence (AI)/machine learning (ML) algorithms.37 Because AANs must include a “statement of specific reasons” the adverse action was taken, these technologies can present challenges to creditors because the specific way in which they operate to inform credit decisions may be based on complex interrelationships. As discussed next, regulators have issued some guidance in this area.

**Adverse Action Notification When Alternative Data Are Used**

In December 2019, the banking agencies issued the Interagency Statement on the Use of Alternative Data in Credit Underwriting (interagency statement).38 The interagency statement noted that some creditors are using alternative data (defined as information not typically found in a consumer’s credit report file or that consumers customarily provide during applications for credit)9 to evaluate borrowers’ repayment ability, including bank account cash flows. The interagency statement noted the creditors’ use of cash flow data can generally be explained and disclosed to the applicant consistent with the AAN requirements in the ECOA and the FCRA.40

Appendix C of Regulation B includes sample AAN forms that list some of the factors creditors commonly consider in taking adverse action. However, when a creditor uses alternative data in the credit decision and the application is denied based on that data, the factors listed in the Appendix C forms may not be suitable. Appendix C states that if reasons commonly used by the creditor are not provided on the form, the creditor should modify the checklist by substituting or adding other reasons.41 This flexibility may be useful when applying the AAN requirements to denied applications that were based on alternative data.

**Adverse Action Notification When AI/ML Models Are Used**

According to research from the Consumer Financial Protection Bureau (Bureau), 26 million consumers (about one out of 10 adults in America) could be considered credit invisible because they do not have a credit record at the three national credit bureaus.42 The Bureau also noted that another 19 million consumers have too little information to be evaluated by a widely used credit scoring model.43 Underwriting models that use AI/ML technologies to automate credit decisioning may allow lenders to evaluate other information about credit applicants beyond traditional credit bureau report data.

**Third-Party Compliance Tip**

Insufficient internal controls for monitoring third parties that are used for an AAN may elevate compliance risks.

However, the use of AI/ML technologies in credit decisions can pose similar challenges as alternative data in determining and disclosing in the AAN the specific reason(s) for taking adverse action. In the Bureau’s blog post titled “Innovation Spotlight: Providing Adverse Action Notices When Using AI/ML Models,” informal guidance is provided on this emerging issue.44 The Bureau noted that Regulation B provides flexibility that can be compatible with AI algorithms. For example, although a creditor must provide the specific reasons for an adverse action, the commentary clarifies that a creditor is not required to describe how or why a disclosed factor adversely affected an applicant, or for credit scoring systems, how the factor relates to creditworthiness.45 Thus, a creditor may disclose a reason...
for taking adverse action, even if the relationship between the factor and the credit decision may not be clear to the applicant. This flexibility may help creditors when issuing AANs based on AI models in which the variables and key reasons are known but may not be clear to the consumer.

The Bureau also noted that Regulation B does not mandate the use of any particular list of reasons. Instead, creditors must accurately describe the factors actually considered and scored by a creditor, even if those reasons are not reflected on the current sample forms.

**RECORD RETENTION REQUIREMENTS**

In general, a creditor must preserve all written or recorded information for a credit application for 25 months (generally 12 months for business credit) after the date on which the creditor informed the applicant of the action taken on an application or of incompleteness. The 25-month retention rule also applies when a creditor offers credit to potential customers. For withdrawn applications, the financial institution must retain applications for 25 months from the date the applicant withdrew it.

**SOUND PRACTICES**

The Uniform Interagency Consumer Compliance Rating System (CC Rating System) notes that all institutions, regardless of size, should maintain an effective compliance management system (CMS) tailored to the size, complexity, and risk profile of the entity. Compliance officers can apply CMS elements to their adverse action notification activities to help ensure compliance. For example, ensure that the AAN rules are sufficiently explained in policies and procedures, provided in training materials for staff with related responsibilities, and included in compliance monitoring activities. As noted in the CC Rating System, strong compliance programs promote consumer protection by preventing, self-identifying, and addressing compliance issues in a proactive manner.

**CONCLUSION**

This follow-up article reviewed more advanced issues in complying with the ECOA’s AAN requirements, including the emerging issue of AANs when creditors use alternative data or AI/ML in credit decisions. Specific issues and questions should be raised with your primary regulator.
ENDNOTES*

4 See 12 C.F.R. §1002.9(a)(1)(i) and (iv).
5 See Comment 9(a)(1)-6.
6 See Comment 9(a)(1)-6.
7 Combined counteroffer notice is contained in Form C-4 of Appendix C to Regulation B.
8 See Comment 9(a)-4.
9 See Comment 2(f)-1.
10 See Comment 2(f)-6.
11 See Comment 9(c)(1)-1.
12 See 12 C.F.R. §1002.9(c)(i).
13 See 12 C.F.R. §1002.9(c)(3).
14 See Comment 9(c)(3)-1.
15 Combined notice of incompleteness is contained in Form C-6 of Appendix C to Regulation B.
16 See Comment 9(a)(1)-4.
17 See Comment 9-2.
18 See 12 C.F.R. §1002.9(e).
19 See 12 C.F.R. §1002.9(c)(2).
20 See Comment 9(c)(2)-1.
21 See 12 C.F.R. §1002.2(f).
22 See Comment 2(f)-2.
23 See Comment 2(f)-3.
24 See Comment 2(f)-3.
25 See Comment 2(f)-4.
26 See Comments 2(f)-4, 9-5.
27 See Comment 9-5.
28 See Comment 9-5.

29 See Comment 2(f)-5.
30 See Comment 2(f)-5. Additional information is available in the Federal Register notice for the 2003 amendment to Regulation B adding the staff commentary on preapprovals. See 68 Federal Register 13144 (March 18, 2003).
31 See Comment 2(f)-5[ii].
32 See Comment 2(f)-5.
33 See Comment 9(g)-1.
34 See Comment 9(g)-1.
35 See Comment 9(g)-2.
36 See Comment 9(g)-3.
37 A full discussion of AI/ML is beyond the scope of this article. For additional information see the Bureau’s blog post “Innovation Spotlight: Providing Adverse Action Notices When Using AI/ML Models” (July 7, 2020) (Innovation Spotlight).
38 Interagency Statement on the Use of Alternative Data in Credit Underwriting” (December 12, 2019). The Federal Reserve Board discussed the statement for the institutions it supervises in Consumer Affairs letter 19-11.
41 See Appendix C, Instruction 3.
42 See “Credit Invisibles” (May 2015), p. 6.
43 See “Credit Invisibles,” p. 6.
44 See Innovation Spotlight; see footnote 36.
45 See Comments 9(b)(2)-3 and -4, respectively.
46 See Consumer Finance Protection Bureau.
47 See 12 C.F.R. §1002.12(b).
48 See 12 C.F.R. §1002.12(7).
49 See Comment 12(b)(3)-1.
50 See CA letter 16-8, Uniform Interagency Consumer Compliance Rating System (November 22, 2016).

Note: The links for the references listed in the Endnotes are available on the Consumer Compliance Outlook website at consumercomplianceoutlook.org.
FEMA BEGINS RISK RATING 2.0 FLOOD INSURANCE INITIATIVE

The Federal Emergency Management Agency (FEMA) provides flood insurance through the National Flood Insurance Program (NFIP), which borrowers and lenders can use to satisfy the flood insurance purchase requirements of the Flood Disaster Protection Act of 1973 (FDPA) for certain secured loans in special flood hazard areas. FEMA currently has more than 5 million flood insurance policies in force in the United States through the NFIP.

FEMA initiated the Risk Rating 2.0 (RR2) program to more accurately price flood insurance risk. Since the 1970s, FEMA has used a limited number of static measures to determine a property’s risk of flooding, “emphasizing a property’s elevation within a zone on a Flood Insurance Rate Map (FIRM).” FEMA determined that this methodology misprices the actuarial risk of a flood, with some insureds paying too much in premiums for their properties, relative to the flood risk, while others are not paying enough.

RISK RATING 2.0 METHODOLOGY

In contrast to the legacy methodology, RR2 considers many individual variables in pricing policies, including:

- Frequency of flooding;
- Distance to a water source (such as an ocean or river);
- Property’s elevation;
- Cost to rebuild;
- Number of floors; and
- Different types of floods, such as river overflow, storm surge, coastal erosion, and heavy rainfall.

Figure 1 compares the new factors that FEMA will consider in RR2 with the prior factors in the legacy methodology.

FEMA uses the tagline Equity in Action for RR2 to emphasize that its revised methodology will help ensure more equitable pricing because flood insurance premiums will more closely align with a property’s individual flood risk. To that end, RR2 eliminates pricing based on flood insurance zones. FEMA

FIGURE 1: Legacy Versus New Pricing Methodology for RR2

<table>
<thead>
<tr>
<th>LEGACY METHODOLOGY</th>
<th>NEW PRICING METHODOLOGY*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FEMA-Sourced Data</strong></td>
<td><strong>FEMA-Sourced Data</strong></td>
</tr>
<tr>
<td><strong>Rating Variables</strong></td>
<td><strong>Additional Data Sources</strong></td>
</tr>
<tr>
<td>• Flood Insurance Rate Map Zone</td>
<td>• Federal government-source data, commercially available third-party</td>
</tr>
<tr>
<td>• Base Flood Elevation</td>
<td><strong>Cost to Rebuild</strong></td>
</tr>
<tr>
<td>• Foundation Type</td>
<td><strong>Rating Variables</strong></td>
</tr>
<tr>
<td>• Structural Elevation (Special Flood Hazard Area Only)</td>
<td>• Distance to Flooding Source and Flood Type</td>
</tr>
<tr>
<td><strong>1% Annual Chance of Flooding (Frequency)</strong></td>
<td>• Building Occupancy</td>
</tr>
<tr>
<td><strong>Fees and Surcharges</strong></td>
<td>• Construction Type</td>
</tr>
<tr>
<td><strong>Source:</strong> FEMA</td>
<td>• Ground Elevation</td>
</tr>
<tr>
<td></td>
<td>• First-Floor Height</td>
</tr>
<tr>
<td></td>
<td>• Number of Floors</td>
</tr>
<tr>
<td></td>
<td>• Prior Claims</td>
</tr>
<tr>
<td></td>
<td><strong>Broader Range of Flood Frequencies</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Fees and Surcharges</strong></td>
</tr>
<tr>
<td></td>
<td>• Additional variables are not shown here.</td>
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</tbody>
</table>
noted that within the same flood insurance zone, the risk of a flood can vary. For example, a property close to a water source may have a greater risk of flooding than another property in the same zone that is much farther away from the water source.

**EFFECT OF PRIOR CLAIMS**

When a legacy policy comes up for renewal under RR2, FEMA will not consider the property’s prior paid claims in its initial rate calculation. However, if a claim is filed when the RR2 policy is in effect, FEMA will consider claims paid during the prior 20 years when the policy comes up for renewal (see Figure 2). FEMA provides this example to illustrate how prior claims can impact the rate: A legacy policy was originally issued in 2003, with claims paid in 2007 and 2011. When the policy is renewed under RR2 in 2022, the two claims are not considered. After a claim is filed in 2024, all prior claims since 2004 (a 20-year lookback period) are considered when pricing the renewal of the RR2 policy.5

**STATE PROFILES**

FEMA has created state profiles that analyze how RR2 will affect rates in all 50 states and the Virgin Islands, including detailed rate examples in spreadsheets at the zip code and county levels.6

**OTHER CHANGES**

FEMA is phasing out the following features of the NFIP:

- Grandfathering — For properties with policies in effect when a new flood insurance rate map (FIRM) becomes effective, or were built in compliance with a FIRM when constructed, FEMA allowed the insured to retain the prior rate.
- Submit-for-Rates — For buildings for which no risk rate is published, the property owner could submit an application for a rate.
- Preferred Risk Policies — FEMA offered a lower-cost policy for properties in certain flood zones.
- Mortgage Portfolio Protection Program (MPPP) — FEMA offered force-placed insurance policies through the MPPP.

FEMA is retaining features of the NFIP, including:

- Ability to transfer discounts by assigning a policy to a new property owner;
- Current policy limits; and
- Waiving the 30-day waiting period for new loans.

**Effect on Premiums**

FEMA estimates that 23 percent of policyholders nationwide will see a decrease in premiums, effective at renewal, while all others will see an increase. The Homeowner Flood Insurance Affordability Act (HFIAA) generally limits annual increases in flood insurance premiums to no more than 18 percent for individual policies.7 HFIAA imposes a higher annual limit increase of 25 percent for the following properties:

- Nonprimary residences;
- Properties with severe repetitive loss;
- Properties with substantial damage or substantial improvement after July 6, 2012;

**FIGURE 2: RR2 Rating Variables, from 2004 to 2024**

![2004 to 2024 20-Year Rolling Window](source: FEMA)
• Business properties; and
• Properties with substantial cumulative damage.8

While the annual limits in HFIAA prevent immediate implementation of full risk pricing for policies whose premiums are increasing, premiums will eventually rise to full risk pricing over time. FEMA created an infographic (Figure 3) to display the expected pricing changes.

Effective Dates

RR2 was effective on October 1, 2021, for all new policies. Existing policies renewing between October 1, 2021, and March 31, 2022, can renew under RR2 or the legacy rating plan. RR2 will apply to all remaining policies renewing on or after April 1, 2022.

Here are several resources for more information:

- FEMA: Risk Rating 2.0: Equity in Action
- FEMA States Flood Insurance Profiles
- Presentation slides for FEMA’s November 2021 webinar on Risk Rating 2.0

Endnotes*

1 See National Flood Insurance Program.
4 See FEMA Risk Rating Overview.
5 FEMA’s presentation slides for its November 30, 2021, RR2 webinar at slide 21.
6 See FEMA Risk Rating Profiles.
7 See 42 U.S.C. §4015(e).

Note: The links for the references listed in the Endnotes are available on the Consumer Compliance Outlook website at consumercomplianceoutlook.org.
## 2021 Interagency Fair Lending Webinar

On December 7, 2021, Outlook Live hosted its annual interagency fair lending webinar on a variety of fair lending topics. The webinar can be replayed free of charge, and the presentation slides are available on the Outlook Live website.

<table>
<thead>
<tr>
<th>Topic</th>
<th>Speaker</th>
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<tbody>
<tr>
<td><strong>DOJ’s Combatting Redlining Initiative and Recent Enforcement</strong> Adamit Samo-Ondrade, Trial Attorney, U.S. Department of Justice</td>
<td>Samantha Ondrade, Trial Attorney, U.S. Department of Justice</td>
</tr>
<tr>
<td><strong>Government-Sponsored Enterprise Fair Lending Data</strong></td>
<td>Annalyce Shufelt, Senior Attorney Advisor, Federal Housing Finance Agency</td>
</tr>
<tr>
<td><strong>FDIC’s Redlining and Marketing</strong></td>
<td>Sheritta A. Arie, Senior Examination Specialist, Federal Deposit Insurance Corporation</td>
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<tr>
<td><strong>Analyzing HMDA Data Tips for Small to Mid-Sized Credit Unions</strong></td>
<td>Matthew Nixon, Office of Consumer Financial Protection, National Credit Union Administration</td>
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<td><strong>Fintech &amp; Fair Lending Risk</strong></td>
<td>Westra Miller, Senior Counsel, Federal Reserve Board</td>
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<td><strong>Recent CFPB Guidance</strong></td>
<td>C. Christopher Davis, Attorney Advisor, Consumer Financial Protection Bureau</td>
</tr>
<tr>
<td><strong>JPMorgan Chase Bank, N.A, Conciliation Agreement: A Case Study of a Successful Conciliation in a Discriminatory Appraisals Case</strong></td>
<td>Lon D. Meltesen, Office of Fair Housing and Equal Opportunity, U.S. Department of Housing and Urban Development</td>
</tr>
<tr>
<td><strong>Redlining Self-Assessments</strong></td>
<td>Beth Small, Counsel, Bank Advisory, Office of the Comptroller of the Currency</td>
</tr>
</tbody>
</table>
Effective supervision relies on strong collaboration between banking agencies and supervised institutions. Over the years, a growing need for better ways to exchange data outpaced the technology used for supervisory activities. To address this need, the Federal Reserve launched Supervision Central in June 2021. Supervision Central is a centralized tool to facilitate secure data intake, sharing, and collaboration among supervisory staff, bank staff, and other agencies’ staff for safety and soundness and consumer compliance activities at community and regional banking organizations supervised by the Federal Reserve.

Supervision Central is designed to reduce regulatory burden for supervised institutions by providing an easy way to submit documents and information to the Federal Reserve. Data submitted will be reusable across examinations with the goal of reducing the volume of duplicate information requests from the Federal Reserve by making documents previously provided more readily available to supervisory staff. Also, supervised institutions will no longer need to submit the same documents to multiple banking agencies for joint examinations and other supervisory activities because the agencies will be accessing the same documents.

The first phase of Supervision Central laid the foundation by replacing the legacy technology used for supervisory events and ongoing supervision. New features that provide value to all users have been added since the launch and will continue to be added based on user feedback. Your continued feedback on Supervision Central is welcome. If you have comments or questions on Supervision Central, please contact your central point of contact or the examiner-in-charge of your supervisory event. In the future, you will be able to submit your feedback directly to supervisory staff.

The Supervision Central help site contains useful resources to better understand the functionality available, including recordings of live training sessions that were offered in June 2021. You can access the help site by visiting www.supervisioncentral.org.

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Please contact us at outlook@phil.frb.org. We generally grant requests to reprint articles free of charge provided you agree to certain conditions, including using our disclaimer, crediting Consumer Compliance Outlook and the author, and not altering the original text.
 Agencies release annual Community Reinvestment Act (CRA) asset-size threshold adjustments for institutions they supervise. On December 16, 2021, the Board of Governors of the Federal Reserve System (Board) and the Federal Deposit Insurance Corporation (FDIC) announced the annual adjustment to the asset-size thresholds used to define small and intermediate small banks under their CRA regulations as follows:

- **Small bank** means an institution that, as of December 31 of either of the prior two calendar years, had assets of less than $1.384 billion.

- **Intermediate small bank** means a small institution with assets of at least $346 million as of December 31 of both of the prior two calendar years, and less than $1.384 billion as of December 31 of either of the prior two calendar years.

The changes were effective on January 1, 2022.

The Board and the Consumer Financial Protection Bureau (Bureau) announce dollar thresholds in Regulations Z and M for exempt consumer credit and lease transactions. On December 1, 2021, the Board and the Bureau published dollar thresholds that will apply under Regulation Z (Truth in Lending Act or TILA) and Regulation M (Consumer Leasing Act or CLA) for determining exempt consumer credit and lease transactions, respectively, in 2022. The annual adjustment is based on the annual percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). If the CPI-W has not increased, the Board and the Bureau maintain the exemption threshold from the prior year.

Transactions at or below the thresholds are subject to the protections of the regulations. Based on the annual percentage increase in the CPI-W as of June 1, 2021, the protections of TILA and the CLA generally will apply to consumer credit transactions and consumer leases of $61,000 or less in 2022. Note, however, that private education loans and loans secured by real property (such as mortgages) are subject to TILA regardless of the loan amount.

Agencies announce the threshold for smaller loan exemption from appraisal requirements for higher-priced mortgage loans. On December 1, 2021, the Board, the Bureau, and the Office of the Comptroller of the Currency (OCC) announced the threshold exempting loans from special appraisal requirements for higher-priced mortgage loans during 2022 will increase from $27,200 to $28,500. As with the Regulation Z and Regulation M thresholds discussed previously, adjustments are made annually to the threshold based on the change in the average of the CPI-W. Special appraisal requirements for higher-priced mortgage loans include a requirement that creditors obtain a written appraisal based on a physical visit to the home’s interior before making a higher-priced mortgage loan. The rules contain an exemption for loans of $25,000 or less, with that threshold also adjusted annually to reflect increases in the CPI-W average.

The Bureau issues a request for information (RFI) to help assess the effectiveness of its 2015 final Home Mortgage Disclosure Act (HMDA) rule. On November 22, 2021, the Bureau published an RFI in the Federal Register seeking input from the public on its plans to voluntarily assess the effectiveness of its 2015 final rule and related amendments (the HMDA Rule), which implemented amendments to HMDA in §1094 of the Dodd–Frank Act, in meeting HMDA’s goals and the objectives of the Dodd–Frank Act, which include monitoring discrimination in mortgage lending. Section 1022(d) of the Dodd–Frank Act requires the Bureau to assess the effectiveness of a significant rule not later than five years after its effective date. The Bureau determined that the HMDA Rule is not a significant rule for the purposes of §1022(d) but is voluntarily assessing it because it “recognizes the importance of the HMDA Rule … and believes that the public would benefit from the Bureau conducting a voluntary assessment.” See 86 Federal Register at 66227.

The Bureau’s assessment will focus primarily on the following areas:

- Institutional coverage and transactional coverage;
- Data points;
- Benefits of the new data and disclosure requirements; and
- Operational and compliance costs.

The press release for the RFI referenced the findings of the Bureau’s recent reports analyzing HMDA data. An August 2021 report on residential mortgage lending trends analyzed

*Links to the announcements are available in the online version of Outlook at consumercomplianceoutlook.org.*
2020 HMDA data and found that Black and Hispanic applicants are more likely to be charged higher interest rates or denied mortgage credit than White applicants. The press release also referenced a July 2021 report on Asian American and Pacific Islander mortgage borrowers that also analyzed 2020 HMDA data and found that certain subgroups “fared better than others in the mortgage market. For example, Chinese and Asian Indian borrowers paid lower interest rates, on average, than non-Hispanic White borrowers. On the other hand, even though they had higher average credit scores and incomes, and lower combined-loan-to-value (CLTV) ratios, their denial rates were higher than that for non-Hispanic White borrowers.” (See report at p. 5.) The press release also noted that the July report was able to leverage the expanded reporting of racial and ethnic subgroups required in the 2015 final rule. The deadline for commenting on the HMDA Rule RFI was on January 21, 2022.

Agencies update their prior “COVID-19 Joint Statement on Supervisory and Enforcement Practices Regarding the Mortgage Servicing Rules in Response to the Continuing COVID-19 Pandemic and CARES Act.” On April 3, 2020, the Board, the Bureau, the FDIC, the National Credit Union Administration (NCUA), the OCC, and State Financial Regulators (agencies) issued a joint statement in response to the COVID-19 pandemic announcing their supervisory approach to enforcing the mortgage servicing rules under Regulation X, 12 C.F.R. Part 1024. The statement said the agencies would not initiate supervisory actions against servicers that fail to meet certain timing requirements under the mortgage servicing rules if they made good faith efforts to provide those required notices or disclosures and took the related actions within a reasonable period of time.

On November 10, 2021, the agencies issued a statement to update this prior guidance, noting that while the pandemic continues, servicers have had sufficient time to work with affected consumers and develop more robust business continuity and remote work capabilities. As a result, the agencies will apply their respective supervisory and enforcement authorities, when appropriate, to address any noncompliance or violations of the Regulation X mortgage servicing rules that occur after the date of the statement. The Federal Reserve Board issued Consumer Affairs letter 21-6 to announce the news to the institutions it supervises.

Federal bank regulatory agencies issue a guide to help community banks evaluate fintech relationships. On August 27, 2021, the Board, FDIC, and OCC (agencies) published a guide Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks to help community banks assess risks when considering relationships with financial technology (fintech) companies. The guide notes that fintech companies “can provide community banks with many benefits, such as enhanced products and services, increased efficiency, and reduced costs, all bolstering competitiveness. Like other third-party relationships, arrangements with fintech companies can also introduce risks. Assessing the benefits and risks posed by these relationships is key to a community bank’s due diligence process.” The guide discusses six key areas of due diligence when a community bank is considering partnering with a fintech company: business experience and qualifications, financial condition, legal and regulatory compliance, risk management and control processes, information security, and operational resilience. The guide also identifies potential sources of information that may be useful to help evaluate fintech companies.

The Department of Housing and Urban Development (HUD) proposes to accept private flood insurance for mortgages insured by the Federal Housing Administration (FHA). On November 23, 2020, HUD published a notice in the Federal Register to amend its implementing regulations for FHA-insured mortgages secured by property in a special flood hazard area (SFHA) to permit borrowers to have the option of obtaining private flood insurance meeting the statutory definition of that term in §100239 of the Biggert–Waters Flood Insurance Reform Act of 2012 (42 U.S.C. §4012a(b)(7)). Currently, if these loans are secured by property in an SFHA, as defined by FEMA, the borrower must obtain flood insurance through the National Flood Insurance Program to satisfy the mandatory purchase requirements of the Flood Disaster Protection Act of 1973. HUD is also proposing a “compliance aid” provision to help mortgagees evaluate whether a policy meets the definition of private flood insurance. The comment period closed on January 22, 2021.
Fifth Circuit stays the effective date of the Consumer Financial Protection Bureau’s (Bureau) payday regulations, in the latest step in litigation, until 286 days after the appeal challenging them is decided. Community Financial Services Assoc. of America, Ltd. v. Consumer Financial Protection Bureau, No. 21-50826 (5th Cir. October 14, 2021). In 2017, the Bureau issued a final rule to regulate payday, vehicle title, and certain high-cost installment loans. See 82 Federal Register 54472 (November 17, 2017). The rule addressed two discrete topics. First, it imposed ability-to-repay (ATR) and associated recordkeeping and reporting requirements on covered short-term and longer-term balloon-payment loans (mandatory underwriting provisions). Second, the rule established certain requirements and limitations on attempts to withdraw payment from a consumer’s account for a covered short-term loan, longer-term balloon-payment loan, or high-cost installment loan after the second consecutive attempt if the prior attempts failed because of insufficient funds (payment provisions). The rule exempted certain loans from coverage, including accommodation loans when a lender and its affiliates make 2,500 or fewer covered loans in a calendar year and meet certain other requirements. On April 9, 2018, a trade group filed a legal challenge to the rule in the U.S. District Court for the Western District of Texas. On June 17, 2019, the Bureau issued a final rule to delay the August 19, 2019, mandatory compliance date to November 19, 2020, and subsequently amended the rule to revoke the mandatory underwriting provisions, while the payment provisions remained in place. See 85 Federal Register 44382 (July 22, 2020). The district court then issued orders to stay the compliance date until finally granting summary judgment in favor of the Bureau in September 2021 and setting June 13, 2022, as the compliance date for the payment provisions. The trade group appealed and asked the Fifth Circuit to grant a temporary stay pending the outcome of the appeal. On October 14, 2021, the Fifth Circuit stayed compliance with the payment provisions until 286 days after the appeal is resolved.

Eleventh Circuit vacates its decision holding debt collectors sharing private consumer information with their vendors violates the Fair Debt Collection Practices Act and agrees to have the entire court review the appeal (en banc). Hunstein v. Preferred Collection & Management Services, Inc., 17 F.4th 1103 (11th Cir. 2021)(en banc). In April 2021, the Eleventh Circuit held that a debt collector transmitting private debtor information to a third-party mail vendor violates the privacy protections of the Fair Debt Collection Practices Act (FDCPA). Hunstein v. Preferred Collection & Management Services, Inc., 994 F.3d 1341 (11th Cir. 2021). The defendant and several trade groups petitioned the court to rehear the case, arguing among other reasons that the Supreme Court’s subsequent decision on standing in TransUnion LLC v. Ramirez, 141 S. Ct. 2190 (2021) affected the ruling. In October, the court granted the petition and issued a new decision, Hunstein v. Preferred Collection & Management Services, Inc., 2021 WL 4998980 (11th Cir. October 28, 2021) that analyzed the standing issue in light of Ramirez and concluded, with one judge dissenting, that the plaintiff had standing and the debt collector violated the FDCPA by sharing private medical information about a debtor’s son with the debt collector’s third-party mail vendor (in effect, affirming its original decision). The Eleventh Circuit has now vacated the panel’s decision, and the entire court will hear the case en banc.

District court denies motion to dismiss class-action lawsuit alleging the available balance method in the opt-in notice disclosing the institution’s practices for overdraft fees violated Regulation E. Grenier v. Granite State Credit Union, 2021 U.S. Dist. LEXIS 215349 (D.N.H. November 8, 2021). Regulation E prohibits a financial institution from imposing a fee on a consumer account to pay an overdraft for an ATM or one-time debit card transaction unless the consumer is provided with an opt-in notice describing the institution’s overdraft practices, and the consumer opts in. See 12 C.F.R. §1005.17(b). Institutions use either the actual or available balance method to assess overdraft fees. The actual balance (aka, the ledger balance) is based on a consumer’s actual account balance when an ATM or debit card transaction is initiated, while the available balance method examines the current balance and pending transactions and holds that could affect the balance. An overdraft is more likely to occur when the available balance method is used. In this case, the institution used the available balance method and disclosed its
overdraft practices using Model Form A-9 of Regulation E, which states in relevant part: “An overdraft occurs when you do not have enough money in your account to cover a transaction, but we pay it anyway.” The institution’s account agreement disclosed its use of the available balance method.

The plaintiff’s class-action lawsuit alleged that disclosing the available balance method using the language from the model form violated Regulation E because it did not comply with the regulation’s requirement that disclosures be made in a “clear and readily understandable” way. See 12 C.F.R. §1005.4(a)(1). The institution argued its use of Form A-9 provided a safe harbor, but the court noted that under the Electronic Fund Transfer Act, which Regulation E implements, the safe harbor only applies to “any failure to make disclosure in proper form if a financial institution utilized an appropriate model clause issued by the Bureau or the Board.” See 15 U.S.C. §1693m(d)(2) (emphasis added). The court denied the motion to dismiss, which procedurally allows the lawsuit to proceed but does not decide the ultimate legal issues.

The Ninth Circuit, sitting en banc, rejects the city of Oakland’s Fair Housing Act (FHA) claim that it lost property tax revenue and had increased municipal expenses because of predatory mortgage loans. City of Oakland v. Wells Fargo & Co., 14 F.4th 1030(9th Cir. 2021)(en banc). The city of Oakland, California’s lawsuit alleged Wells Fargo violated the FHA by targeting minority borrowers with predatory loans that harmed Oakland because of decreased property tax revenue and increased municipal expenditures when the loans disproportionately defaulted and went into foreclosure. Under the FHA, a person injured by a discriminatory housing practice has standing to file a suit for damages. A prior panel of the Ninth Circuit held that Oakland had sufficiently pleaded proximate cause for the decreased property tax revenue claim. But the court dismissed the municipal expenditure claim because Oakland had failed to plead proximate cause for the claim. The court reasoned that Oakland had not sufficiently accounted for other factors that could have increased its expenditures and remanded Oakland’s claim for injunctive relief to the district court to determine if Oakland satisfied the proximate cause requirement for this claim. See City of Oakland v. Wells Fargo & Co., 972 F.3d 1112, 1137 (9th Cir. 2020). Wells Fargo petitioned the court to rehear the case en banc, and the court granted the petition and vacated the panel’s decision. See 993 F.3d 1077 (9th Cir. 2021).

The en banc court noted that the U.S. Supreme Court clarified in a similar case that a municipality’s claim for lost tax revenue for an FHA violation was only actionable if it could establish “the harm alleged has a sufficiently close connection to the conduct the statute prohibits.” See Bank of America Corp. v. City of Miami, 137 S. Ct. 1296, 1305 (2017). The court therefore focused on whether Wells Fargo’s alleged lending practice proximately caused Oakland’s damages. The court noted the plaintiffs’ claims that “Wells Fargo’s discriminatory lending practices caused higher default rates, which in turn triggered higher foreclosure rates that drove down the assessed value of properties, and which ultimately resulted in lost property tax revenue and increased municipal expenditures. These downstream ‘ripples of harm’ are too attenuated and travel too ‘far beyond’ Wells Fargo’s alleged misconduct to establish proximate cause.”

Oakland argued that the City of Miami opinion upheld legal standing for Miami to assert claims similar to the ones Oakland is alleging here, and “[i]t would be illogical for Oakland to have standing under the FHA to pursue lost property taxes and increased municipal expenses, but still be unable to state a claim for those very same injuries under the FHA’s causation standard.” But the court said the standard for establishing legal standing is different from the standard for establishing proximate cause. Regarding proximate cause, the court noted the challenge in attributing Oakland’s damages to Wells Fargo’s lending practice. For example, a borrower could default on a loan for reasons unrelated to Wells Fargo’s lending practices “such as job loss, a medical hardship, a death in the family, a divorce, a fire or other catastrophe, Covid-19, broader economic trends, or any number of other unpredictable causes not present when the loan was made.”

* Links to the court opinions are available in the online version of Outlook at consumercomplianceoutlook.org.
## REGULATORY CALENDAR

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| 10/01/22                        | Final rule to extend the sunset date for the temporary Government-Sponsored Enterprise (GSE) Qualified Mortgage (QM) loan definition  
Note: The GSEs announced in May 2021 that they can no longer purchase Patch GSE QM loans after June 30, 2021, despite the Bureau’s extension to October 1, 2022 |
| 04/01/22                        | Final rule amending Regulation Z to facilitate the transition from the LIBOR interest rate index |
| 01/01/22                        | Final rules establishing dollar thresholds for credit exempt from Regulations Z and M |
| 01/01/22                        | Final rule establishing loan exemption threshold for appraisals of higher-priced mortgages for 2022 |
| 01/01/22                        | Final rule establishing 200 loans as the permanent Home Mortgage Disclosure Act data reporting threshold for open-end lines of credit |
| 11/30/21                        | Final rule creating implementing regulations for the Fair Debt Collection Practices Act |
| 09/17/21                        | Office of the Comptroller of the Currency issues rulemaking proposal to rescind its June 2020 CRA modernization rule and replace it with future interagency CRA modernization rule |
| 09/01/21                        | Consumer Financial Protection Bureau (Bureau)’s §1071 rulemaking proposal for lenders to collect and report data on small business credit applications, including women and minority-owned businesses |
| 08/31/21                        | Temporary rule requiring servicers to follow procedural safeguards before they can initiate foreclosure until January 1, 2022, and allowing loss mitigation on certain incomplete applications |
| 08/12/21                        | Interpretive rule: Impact of the 2021 Juneteenth Holiday on certain closed-end mortgage requirements |

† Because proposed rules do not have an effective date, we have listed the Federal Register publication date.
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2022 CALENDAR OF EVENTS

June 21-24
American Bankers Association Regulatory Compliance Conference
Hyatt Regency Orlando
Orlando, FL

The event may be held virtually or as a hybrid, as necessary.